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Fédération Européenne des Conseils et Intermédiaires Financiers

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The "Fédération Européenne des Conseils et Intermédiaires Financiers" (European Federation of Financial Advisers & Financial Intermediaries) is the unique grouping of national trade associations in Europe, representing 300,000 intermediaries across Europe.

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1 INTRODUCTION

The **Fédération Européenne des Conseillers et Intermédiaires Européens** (FECIF), was chartered in 1999 for the purpose to defend and promote the role of financial advisers and intermediaries in Europe; this was at the initiative of three distribution networks and three trade associations from France, Luxembourg and the United Kingdom.
FECIF is today the only trade body representing European financial advisers and intermediaries in Europe.

- 24 national trade associations representing 247,896 registered intermediaries from 12 European Union (EU) Member States
- 1 financial institutions operating cross border
- 13 pan European commercial networks incorporating 34,150 registered intermediaries operating across 22 EU Member States

FECIF has also set-up two national chapters, FECIF-France and FECIF-Poland to accommodate the smaller local national associations; FECIF has few individual members.

The number of intermediaries (tied agents, multi-tied agents, brokers, advisers, financial planners) operating across the 27 EU Member States has dramatically reduced from 635,000 in 2008 to 596,000 in 2009.

The number of individual intermediaries member of national trade associations went down from 386,800 in 2008 to 297,980 in 2009.

Largely, intermediaries have been victims of the crisis but also of the new regulatory requirements imposed by some national regulators pushing many senior intermediaries with twenty or more years of professional expertise either out of business or to join an institution as a salaried employee.

FECIF has made a survey in September 2009 on 1,245 intermediaries and 3,124 consumers (existing and/or potential clients of intermediaries member of FECIF) from 10 EU Member States:

- 37% of the total number of consumers contacted prefer to deal through an intermediary because of the personal attention they received at the occasion of a face-to-face meeting
- 30% better trust an institution to handle their financial affairs, feeling secured by the size of the bank and/or the insurance company
- 18% prefer to rely on the assistance of a friend or a member of the family
- 12% refer their queries to another professional (accountant, tax adviser, lawyer, etc.)
- 3% handle their affairs directly through the Internet

It is rather fascinating that 70% of the consumers do not feel comfortable dealing with a bank and/or an insurance company directly.

When questioned about the issues related to provision of information to existing and/or potential clients, the intermediaries identify the problems as follows:

What is/are the main problem(s) you are facing in your day-to-day business life?	2008	2009
Relationship with the product provider(s)	47%	41%
Relationship with the regulator	31%	35%
Relationship with the clients	12%	10%
Technology	6%	8%
Relationship with the employees	4%	6%
How would you describe the nature of the problem(s) you are facing?		
Poor service/Inefficient administration/Heavy handed bureaucracy	58%	56%
Incorrect legal information/Ignorance of EU rules-local rules	35%	34%
Products/services not in ad equation with clients' demands	7%	10%

It seems that beside the burden imposed on intermediaries/consumers by the local implementation of EU rules, there is a serious lack of communication between product providers and intermediaries when the relationship with clients apparently is not an issue.

As a perfect example of lack of efficiency of national regulation regarding circulation of information related to a product, Italy is the winner: the CONSOB (the Italian lead regulator) will require for a typical unit-linked standard life policy contract (regular premium & single premium) mixing a diversified portfolio of 20 funds not less than 40 term sheets including all supporting documents totaling 613 pages. If a consumer requires copy of the Part I – II & III of the registration, he will receive a package of 400-450 pages. The simplified prospectus for the same contract with two funds only is of 14 pages …

The EU is made of 27 Member States speaking 23 official national languages, and the financial services industry is regulated and controlled by 62 different authorities employing more than 15,000 bureaucrats. The compliance cost ranges from 4% of the General & Administrative expenses budget of a large institution up to 35% for a small intermediary firm… Incidentally, about 45% of all unnecessary costs are caused by the Anti-Money Laundering regulation which has been described as "totally useless" by anti-terrorist specialists in the US!

Few more examples: 70% of IT development are caused by regulation, 30% only are market driven for the benefit of consumers!

The implementation of the **Markets in Financial Instruments Directive** (MiFID) is estimated to cost to the industry over 1 billion € that will be passed one way or another on to the consumer.

The requirement of data storage to comply with MiFID alone will increase by 400% and MiFID could reduce earnings of the industry by 7%.

2 OVERVIEW

The role and importance of European independent financial intermediaries (styled in English as "IFA") firms in the distribution process of financial products and services expanded dramatically since the crisis.

However, there has been a 10% rise in IFA firms in the UK since depolarization, according to IFA Promotion (IFAP). The research confirms provider predictions that depolarization would see a sharp contraction in the IFA sector were well wide of the mark. IFAP says the research shows the IFA community is more robust than ever.
The research also shows that 63% of IFAs have their own website while 96% are now contactable through email.

IFAP chief executive David Elms says: "Over the last few years, the advice industry has rapidly changed. Regulatory changes coupled with a more informed customer, have led to IFA firms re-evaluating their business models. The client is king and IFAs are responding to consumer demand – but there is still more that they can do."

The European consumer gradually becomes more used to the idea of independent advice and the accessibility of new products and this trend is complemented by the slow political movement to a Single European Market in Financial Services.

The professional advice and mediation are today penalised by extremely constraining regulations, the soaring cost of compliance procedures, too often unreliable new technologies, and the demands of a generally distressed and ill-informed clientele.

After the crisis, we expect that this situation will change in the future under the pressure of the industry and of the consumers' groups, enhanced by due industry consultation. We wish to see the European Commission (EC) to adopt a flexible and targeted approach to EU initiatives and legislation, to use non-legislative measures where possible (i.e. self or co-regulation, codes of conduct, ombudsman, etc.), to resort to legislation only when necessary, to make existing legislation more coherent and simple where possible.

We wish to see the promotion of fair, competitive, transparent, efficient and integrated financial markets. Definitions of Financial Services often differ from country to country and it is challenging to find common notions across all EU Member States, definitions that are consistent and coherent with economic requirements.

We express a serious concern about the cost of implementing the detailed policies and procedures concerning inter alias: the reporting to clients, the best execution obligations and the pre and post trade transparency. Most large players in the market are starting to increase their minimum transaction costs on the purchase or sale of negotiable securities. The consequence of such a move, **excludes the retail investor** from direct ownership of securities and in the long run we do not believe that this is a positive trend. Our calculations show that a retail investor wishing to invest €50,000 in the shares of 20 European companies for minimum diversification, with a 25% rate of turnover (i.e. shares are held for an average of 4 years) will incur an additional charge of ½% (one half of one percent) of his portfolio per annum.

The principle of precaution which justifies the “nanny state” ambient philosophy may unfortunately push tens of thousands of people out of business. It is essential the EC seeks to create a real single market by eliminating unnecessary host country rules and options that act as barriers to cross-border business.

3 MISSION STATEMENT

FECIF shows its determination in the representation of the fundamental interests of its members by advocating the principle of **co-regulation** (or joint-regulation) of the profession in an environment that too often tends to be excessively regulated - to the detriment not only of consumers' interests, but also those of the economic actors.

"Politics, protectionism and cultural clashes could dash Europe's dream of a single market" was the title of an article published in the *Financial Times*.

There is probably no future for banking secrecy in the politically correct EU – but in the meantime the EC under pressure of the consumers' groups is working hard to improve the level of data protection against all sort of possible breach of confidentiality.

EU citizens will need also to be protected against the zealous enthusiasm of magistrates mainly politically driven by their own local ambitions in their home countries as it is the case in Belgium, France or Italy.

EU citizens should have the right to freely use wealth accumulated throughout a lifetime to meet their family needs at the time of retirement, bearing in mind that taxes have already been paid on salary income, consummation spending, property, etc. throughout a lifetime…

It must be a basic right for EU citizens to select the right investment within taxed environment despite the unlimited appetite of politicians for state overspending. Europeans should not have to finance the cost of the 35-hours rule implemented by the French socialists or the closure of the car racetrack of Spa-Francorchamps decided by the Belgian Greens!

To avoid excessive taxation in order to maximise return on investment is a logical objective for any individual and the lack of consideration for some very basic democratic principles has been the caused for most of the slowdown in the EU legislative process. Anyone who tries one day to open a business branch in Belgium, the Netherlands or Portugal will understand what it means!

Respect for fair competition is one of these very basic principles. Our dear politicians should not turn the EU from a tax heaven (which is certainly not) – into a tax evil!
In spite of significant advances in the legislative process towards the completion of the **Financial Services Action Plan** (FSAP), there are still some serious limitations to the free movement of persons and services within the EU.

In order to make some of the changes acceptable to both the consumer and the industry, a fair split of responsibility is needed between the consumer, the intermediary, the provider and the state – a basic concept of democracy.

As a non-profit association, FECIF is an independent organisation at the exclusive service of its members from the 27 EU member states, the British Isles, Gibraltar, Norway and Switzerland.

FECIF has set itself the objective of supporting the development of the concept of professional financial advice and intermediation in the EU, to better serve the interests of the consumer:

- to unite and co-ordinate the operations of the various EU professional associations representing the financial advice and mediation sector, without any distinction,

- to represent its members in the context of negotiations with the various bodies of the EU in order to protect their moral, professional and economic interests, and to play an active role in the development of proposals relating to the organisation and regulation of the professional activities of its members within the EU,

- to encourage the exchange of information between members and to facilitate the circulation of the recommendations and/or rules adopted by the competent regulatory bodies,

- to define, by basing itself on certain self-monitoring mechanisms, the necessary vocational training, the means of evaluating skills and the essential rules for guaranteeing the protection of the interests of this sector and its image with the public.

Further to the current financial crisis, it is a matter of time before retail investors in most EU members states turn away from the banks where they have traditionally bought their financial products, and toward the independence and greater product ranges offered by independent intermediaries.

The intermediary has two functions, to advice on generic products, and to take client's needs and buy the products he requires.

In the changing EU financial services industry, intermediaries are on the move, hoping to draw customers away from more established channels such as banks or from expanding routes such as on-line services where no advice is offered.

Intermediaries say they generally offer customers access to a selection of providers and banking and insurance products, as well as the guidance that should be an essential part of investing.

There are very different levels of consumer protection from a EU member state to another member state. Germany did not have any legislation on intermediaries when in some EU member states intermediaries may be required to sell only locally approved products to consumers.

As some EU governments grapple with strained state budget and the prospect of pension reforms, their citizens are starting to think about providing for their own retirements. In addition, low interest rates and tax regimes favour certain asset.

In the past decade, the growth in demand for intermediary services to help people select products has varied across Europe.

In the UK in 1998, where buying financial products through a third party was considered the norm, more than 60% of sales of financial vehicles like mutual funds were conducted through advisers, more than double the amount sold through intermediaries in 1992, according to the country's trade association.

But last year in Sweden, 30% of such vehicles were sold through intermediaries, and in Germany the number was 24%, according to the national associations. In countries like France and Austria, intermediaries have market shares less than 10%.

Consumer groups anticipate that the use of intermediaries will develop in line with the proliferation in products.

The representative of the industry should manage (or co-manage) the registrar of intermediaries who do not handle consumer's funds, divided in three categories (to comply with distinct Directives): (a) Mortgage (b) Insurance/Life and Pension (c) Investment.

The national associations should be responsible to monitor their membership to ensure that it follows the guidelines as transposed into law under the IMD and/or MiFID.

This model has been in operation in Italy for many years, it has been implemented in France and in Austria.

The EC is certainly not opposed to any of the above, nor the "Grand fathering" from the regulators on to a national association(s) register.

The EU legislation says that regulatory authorities shall be either public authorities or bodies recognised by national law or by public authorities expressly empowered for that purpose by national law.

EU member states shall designate the competent authorities empowered to ensure implementation of EU directives.

4 THE CRISIS

Introduction

In the wake of G20 meeting, all the emphasis at world level is once again focused on regulation, when it should really be a time to follow the old Clinton adage of "it's the economy, stupid".
There are enough rules and regulations, just that the arrogant and highly incompetent regulators didn't want to impose the rule on the one they were supposed to supervise.
Much easier to play the FBI agent with an independent insurance broker than checking what's going on in the trading room of a big bank!
Many countries across the world and especially in Europe will have only to instruct their lazy bureaucrats to wake up and control the right people. Big is not necessarily beautiful!

Vincent J.Derudder, Secretary General of FECIF

Lessons from the liquidity crisis and the Madoff collapse

(Source: EFAMA Annual Report 2008-2009)

The subprime or credit market crisis that started in mid-summer 2007 led to serious market turmoil and severe consequences for the asset management industry. A new peak was reached in September 2008 when Lehman Brothers declared bankruptcy. Stock markets crashed and nearly all large banks across the globe were left with portfolios of worthless securities. Late 2008 saw the financial crisis hitting the 'real economy', though by early spring 2009 the worst seemed to be over, at least as far as the liquidity crisis was concerned.

Towards the end of 2008 it became clear that the crisis would have a significant impact on the regulatory framework for financial services not only at European level, but through the G 20 initiative at a global level as well. As far as Europe was concerned, the European Commission stated in no uncertain terms that the industry would have to accept the fact that more regulation was needed and that simply offering more self-regulation would not be sufficient. One of the challenges for European Fund and Asset Management Association (EFAMA) will be to avoid having "overregulation".

As if this were not enough, in late December 2008 the European investment fund industry was seriously shaken by a huge fraud scandal in the United States, the 'Madoff Affair', calling into question one of the key pillars for investor protection in the Undertakings for Collective Investments in Transferable Securities (UCITS) regulatory framework: the UCITS depositary.

Impact of the financial crisis on the fund and asset management industry

4.1 MACRO IMPACT OF THE CRISIS

4.2.1 In terms of flows the crisis led to a massive retreat for six quarters in a row (summer 2007 up to the end of 2008) but flows have stabilised since the end of 2008.

- The first impact of the financial crisis became apparent in August 2007 with the outbreak of the subprime crisis due to the relative importance and success of the so-called enhanced money market funds. In a matter of weeks, €70 bn were redeemed in funds predominantly from institutional investors; around 15-20 suspended redemptions for a short period, 4 of them were definitively closed.

- From the summer 2007 to the end of 2008, the European industry has experienced 6 quarters in a row of massive net outflows. Total assets under management of European asset management fell by some 20% in 2008 and declined from 13.6 trillion at the end of 2007 to 10.7 (estimated) at the end of 2008. The assets of investment funds domiciled in Europe fell by 1,567 bn (or 25.4%) in 2008. This decline was driven by the developments in the UCITS market, which represents about 75% of the investment fund market in Europe. Market losses impacted by nearly 77% the decline in UCITS assets, whereas net outflows were responsible for 23% or 336 billion of the UCITS assets decline. Those outflows were driven notably by outflows in long-only funds due to a massive retreat to safety, deleveraging and market dysfunctioning. Long-term products suffered over €400 bn of outflows in equities, even more bond funds and mixed assets; 90% of the total outflows originated from 4 countries, i.e. Luxembourg, where most of the UCITS are domiciled, Italy, Spain and France. Also, falling growth prospects in Asia affected the demand for UCITS and the net sales of cross-border UCITS to Asia, which contributed for more than 22 bn in 2007, turned negative in the second half of 2008. Interestingly enough, about 40% of the total outflows from UCITS were recorded in October when the liquidity crisis and the fear of credit and counterparty losses following the bankruptcy of Lehman Brothers were at their peak. In 2008 money market funds were the only class which had overall positive net inflows in UCITS funds of approximately €69 bn as well as in stable NAV funds.

The main reasons explaining why assets and funds were severely hit are threefold:

- the financial crisis had led to massive losses in worldwide stock markets and the meltdown of credit and money markets following the bankruptcy of Lehman Brothers. The financial crisis then turned into a global economic crisis with downward pressure on economic activity;
- an unfair level playing field, triggered by unfair competition with structured notes (until mid 2008) and banking products (cash and deposits) especially in Spain, Italy, Greece and Portugal, and amplified by national governments guaranteeing bank deposits;
- the nature of distribution in continental Europe, which is mainly bank and insurance-driven and where the distribution became a competitor for the fund industry.

Since October 2008 the situation has been improving and net outflows have stabilised, although gross sales have remained at a relatively low level and YTD net inflows are still driven overall by money market funds.

- Outflows tend to stabilise in long-only funds and are relatively small, offering further proof that investors believe that the bottom has been reached.

- The majority of fund managers expect a recovery of net sales of UCITS in 2009 in Europe in the first place, but also in other parts of the world.

4.2.2 Impact on the profitability of asset managers

According to McKinsey, profits of asset managers in Europe plunged to the lowest levels ever: below 13 bn of operation profit (McKinsey Asset Management Survey in 2008). Four key factors have been impacting profitability:

- the bear market which led to a decrease in assets and therefore overall to a significant
- decrease in fees;
- margin pressure owing to increased investor scepticism towards asset management products and reduced negotiating power (many active/alpha products have not proven their value);
- rising share of low-margin products like ETFs and unfair competition, i.e. structured notes;
- overcapacity.

This dramatic profitability implosion is a serious challenge to the asset management business models, leading to a strategic rethinking. Most asset management firms have already been going through, or are in the process of exercises in reducing costs, searching for new partners, launching new products and acquiring other asset management business (McKinsey Asset Management Survey in 2008).

4.2 REGULATORY AND OPERATIONAL ISSUES

A number of key aspects on the regulatory and operational level will be explored in more detail hereafter, but seen from the industry's perspective, three major points can be raised:

- Confidence risks have to be limited by intensifying fraud detection and by improving the market organisation to mitigate systemic risk; the latter can be achieved by:

    - creating more transparency in all markets, especially the OTC (Over the counter) markets;
    - bringing more standardisation and transparency in derivative markets;
    - make post-trade information available;
    - create Central Clearing Platforms for the continuous netting of positions;
    - improve Straight Through Processing in all sectors.

- Weaknesses have appeared in the EU pattern
  In spite of some harmonisation efforts by Directives there are still considerable differences in EU markets in investor protection and disclosure and regulatory arbitrage does exist.
  The home/host system has not delivered and too much reliance was placed on non-binding cooperation between regulators. Cooperation is still weak as was illustrated by the implementation of the short-selling rules.

- A credible system of regulation and supervision has to be created as soon as possible. The present system has proved its limits, it is a bottom-up system, based on national competences, coordination works only be mutual recognition, home-host arrangements and cooperation.
  This leads to either double supervision or gaps in the system. And the system has proved unsatisfactory because the home-host system has not worked in the crisis: emergency action was ringfencing in some States, information flows are weak and cooperation is to be improved.

4.2.1 European Commission identifies weaknesses (Letter from David Wright, December 2008)

In response to a letter from EFAMA in August 2008, David Wright, the Deputy Director General of the Internal Market DG, wrote to EFAMA in December pinpointing a number of weaknesses in today's regulatory framework which need to be addressed by the regulators and the industry.

Credit assessment guidelines

One of the most important lessons to be learnt is the need for proper own credit assessment policies and procedures. EFAMA took the initiative and produced the so-called "Asset Management Industry Guidelines to Address Over-Reliance upon Ratings", providing guidance for asset managers on the responsible use of ratings for securitisation, structured finance and structured credit products. The Guidelines highlight four major principles:

- when investing in structured credit products, asset managers must have regard to their obligation to act professionally and in the best interest of their clients;
- asset managers should understand the limitations to any credit ratings and address the risks arising;
- in the best interests of their clients, where appropriate, asset managers should challenge mandates which appear ill-designed;
- asset managers should periodically assess the adequacy and effectiveness of their arrangements for addressing the Guidelines.

With these Guidelines (that are developed fully in the document), EFAMA responded to the call of the Financial Stability Forum (FSF): "Investors should address their over-reliance on ratings. Investor associations should consider developing standards of due diligence and credit analysis for investing in structured products". The Guidelines reflect the industry's strong commitment to appropriate standards of due diligence and credit analysis. They were prepared jointly with the European Securitisation Forum (ESF) and the Investment Management Association (IMA) as part of an industry-led initiative coordinated by the ESF, the so-called "Ten Initiatives to Increase Transparency in the European Securitisation Markets", first announced in July 2008.

Risk management

As a result of the global liquidity crisis, risk management has been thrown into the spotlight and the importance of asset liquidity has been re-evaluated. Within the UCITS world, very few funds had to close or temporarily suspend redemptions.

Although the crisis highlighted the need for improvements, it demonstrated the overall robustness of risk management procedures.

Committee of European Securities Regulators (CESR) published in August 2008 a consultation on Risk Management Principles for UCITS. It presented a draft of high level principles for risk management, which were published in February 2009 in their final form as Level 3 guidelines for regulators. Further work on methodologies was delayed by other CESR activities, but is now continuing and might provide material either for CESR's Level 2 advice on UCITS IV to the European Commission, or for Level 3 guidance.

EFAMA carried out a survey of Risk Management practices amongst its Corporate Members and later launched a Working Group on Risk Management, which contributed to our reply to CESR's Consultation and will work in more detail on risk management methodologies.

Classification/description of money market funds

The difficulties experienced by a small number of money market funds in Europe and the United States raised concerns about the risk characteristics of money market funds. These concerns led many investors to redeem their shares from money market funds in the autumn of 2008. The difficulties were compounded by the broad extension across Europe of state-supported guarantees to bank deposits. To cope with this situation, EFAMA took two important initiatives, in cooperation with Institutional Money Market Funds Association (IMMFA):

- First, EFAMA engaged in early October 2008 in high-level discussions with the European Central Bank (ECB) about the possibility of obtaining some liquidity support along the line of programmes that had been created by the Federal Reserve to support money market funds in the United States. At the time, the industry feared that a run on money market funds would outpace investment managers' ability to raise liquidity, and force those funds to close to further redemptions. As money market funds are widely held by corporate treasurers, which were already under short-term funding pressure because the market for short-term commercial paper had closed, the risk was that a freezing of money market funds would exacerbate funding problems for financial institutions and corporate investors.

The risk of large-scale redemptions had also led investment managers to refrain from investing in money market instruments with a maturity of more than one week, and in many cases to restrict themselves to overnight deposits. Although this behaviour was individually rational, it was collectively worsening the situation in the money markets themselves.

To reduce liquidity pressure, and to avoid their recurrence, EFAMA proposed that the assets held by money market funds should be treated as eligible collateral by the ECB in respect to loans granted by the ECB to banks.

Another proposal was that the ECB and national central banks should agree to provide liquidity to money market funds facing urgent liquidity problems by accepting to buy money market funds units/shares for a transitional period.

Whilst appreciating our feedback on the problems faced by money market funds as well as our proposal, the ECB did not accept to move away from its traditional policy of conducting credit operations with banks only. Instead, it decided to broaden the scope of eligible collateral to include certificates of deposit which are not traded on "regulated markets". The ECB explained that this step, together with the reduction in interest rates, was an important contribution to support liquidity of short-term money markets that would benefit money market funds. Its position was to assess the effectiveness and adequacy of this action before considering measures specifically targeted at money market funds.

As the pressure faced by money market funds started to recede in November 2008, and in a situation of better functioning money markets, both the ECB and the money market fund industry have gained time to draw the lessons from the financial crisis and evaluate whether or not it would be useful to have the possibility of direct liquidity support from central banks during stress situations.

The European Commission shared our concern that a freezing of money market funds could cause irreversible damage to the European financial system and European economy. In a joint letter to EFAMA's President, Commissioners Almunia and McCreevy confirmed that they remained very vigilant regarding the situation of money market funds and very much interested in discussing developments and possible remedial actions as the situation evolved. On different occasions, high-level officials from the European Commission also stressed the importance of avoiding unilateral national interventions given the systemic nature of the challenges facing the EU industry and regulatory authorities. Eddy Wymeersch, the Chairman of the Committee of European Supervisory Regulators (CESR), also shared with EFAMA and his colleagues from CESR his views on the dangers of divergent national responses to the challenges facing the money market industry.

- The second action taken by EFAMA in direct response to the letter of David Wright was to accelerate its work on a European definition of money market funds, again in close cooperation with IMMFA. The main objectives of this project, which is still under way, are twofold. The first goal is to limit the use of the label "money market fund" to investment funds that give high importance to the objectives of capital preservation and liquidity. To achieve this objective, it will be recommended that money market funds comply with clear-cut criteria aimed at limiting interest rate risk, credit/credit spread risk, liquidity risk and some other risks.

The second goal of the project is to group money market funds in separate categories defined in terms of their specific profile of risk and return. To the extent that some money market funds may seek more risk than others in seeking higher return, the funds' prospectus and marketing material should clearly highlight the differences between each category in terms of objectives and risk-limiting provisions in order to facilitate investor choice.

EFAMA is convinced that the adoption across Europe of a well-defined and fully transparent definition of money market funds will contribute to enhance the attractiveness of money market funds and allow them to continue to play successfully their role as providers of key investment products to retail and institutional investors and key lenders to banks and non-financial corporations.

Central European Clearing House for OTC derivatives

Following the financial crisis and the Lehman collapse, the size of the OTC[1] derivative market – and in particular of the CDS[2] market – has raised significant regulatory concerns and is considered so large as to pose systemic risks. The use of Central Counterparties/Clearinghouses has been therefore deemed to be essential to reduce counterparty risk and to enhance transparency, both to regulators and the market.

In the United States, the process is more advanced, and at least one CCP has already started clearing trades. In Europe, the European Commission has been in discussion with stakeholders since November 2008, seeking commitment from the sell-side to move clearing and settlement to one or more EU CCPs. Location in Europe is seen to be very important for prudential reasons, as approximately half of the global CDS volume is EU business.

The Commission created in November 2008 a Working Group on Derivatives with two tasks: in the short term, to coordinate the move to CCPs, coaxing the various parties around one table and functioning as a forum for the stakeholders to discuss all issues, legal, operational and regulatory. In the longer term, however, the Working Group should give input to the Commission on derivatives in general. The Commission is planning a report to Council in June on its initiatives regarding derivatives, and the move to central clearing and settlement is certain to be recommended for other OTC derivatives.

After a tough negotiation round and under the threat of binding regulation, the European Commission obtained at the end of 2008 a commitment from the sell-side dealers to be ready to start using a CCP as of the end of July 2009. Four European CCP platforms plan to launch, but are at different stages of readiness (only one claims to be ready, two plan to be ready by end July, and one will not be operational until late 2009).

EFAMA supports the Commission's goal of moving clearing and settlement of CDSs to EU CCPs, as their use will greatly reduce counterparty risk. However, it is important that robust solutions be implemented by CCPs in particular with regard to risk management, collateral/margin management, and pricing. Transparency of CCP rules to all users and potential users is also essential. We strongly believe that the asset management industry – as an important part of the buy-side – should play a key role in the discussions on the operating rules for CCPs, although its members will not be direct members of the clearinghouses.

While committed to the goal, there are some concerns about the lack of information from sell-side and CCPs necessary for EFAMA members to be able to make informed decisions. The deadline for implementation (31 July 2009) is approaching fast, and many details are still unclear or not defined. Asset managers must evaluate their processes and their relationships with clearing brokers and depositaries with regard to CDS clearing and settlement, to ensure they are ready in time for the upcoming use of a CCP.

[1] OTC: Over-the-counter
[2] CDS: Credit Default Swap

However, choices should be made carefully on the merits of the different offers, not forced by the asset manager's counterparty preferences or lack of time to adjust systems and processes.

European regulation on credit rating agencies

After difficult negotiations under the Czech Presidency, the European Parliament and Council agreed in April 2009 on a common text of a European regulation on credit rating agencies. EFAMA participated in the debate from the beginning and welcomed the Commission's initiative. Some regulations, i.e. CRD[3], MiFID[4], attributed – regrettably in our opinion – a regulatory status to ratings without regulating the rating agencies themselves. EFAMA members in particular welcomed the Commission's approach to provide for a comprehensive disclosure regime since the capability of asset managers to assess a financial instrument depends in part upon the quality and extent of the information disclosed by the rating agency. This disclosure is considered as a necessary prerequisite for an investor's own risk analysis. EFAMA members identified, however, three shortcomings in the Commission's proposal:

- Firstly, in terms of scope, the use of third country ratings was forbidden. This provision would effectively have banned the trading in Europe of non-EU rated instruments. Fortunately, Council and Parliament agreed on a (rather complex) solution: credit ratings issued in third countries may be used if the rating is endorsed by an EU registered credit rating agency. This possibility will most likely be used by the large credit rating agencies with a worldwide physical presence. For those rating agencies that do not have a physical presence in the EU, a rating to an instrument issued in third countries is eligible if that rating agency is subject to equivalent rules and supervision. Although EFAMA members welcome the fact that the EU legislator did not follow the Commission in its protectionist approach, we have doubts as to what extent the new regulation will really encourage the emergence of new actors on the market given that the endorsement process favours the model of the large agencies and the difficulty to establish equivalence.

- Secondly, with regard to oversight, EFAMA stressed the need for a real European supervisory structure whilst taking into account the limits of the existing EU Treaty. We welcome the idea of using CESR as a single point of entry for the submission of applications for registration, and the idea of creating colleges to deal subsequently with the applications as well as with the day-today supervision. We also agree that this supervisory architecture should not be considered as the long-term solution for the oversight of credit rating agencies, and we are looking forward to the proposals the Commission announced on the basis of the recommendations issued by the de Larosière Group end of February 2009.

- Thirdly, EFAMA members criticised the disclosure regime on structured finance products for being insufficient. The Commission's proposal focused on disclosure by credit rating agencies only and did not sufficiently consider the responsibility of issuers and arrangers to provide for exhaustive disclosure at the first pricing of a security: in the final version of the regulation,

[3] CRD: Capital Requirements Directive
[4] MiFID: Market in Financial Instruments Directive

legislators improved the regime slightly, although more needs to be done to really provide investors with the necessary information.

Since a regulation has to be transposed directly into national law without leaving room for national interpretation, it will enter into force soon. However, appropriate implementing measures to specify certain aspects of the regulation still need to be adopted, in particular with regard to the proposed equivalence mechanism. In order to guarantee that Level 2 rules will take account of asset managers' needs, EFAMA nominated a representative to CESR's Consultative Working Group on credit rating agencies.

UCITS and securitised instruments

In response to the financial crisis, the Commission presented a variety of amendments to the Capital Requirements Directive (CRD), including a new Article on securitisations that had been at the heart of the turmoil. The aim was the alignment of interests between issuers of securitised products such as Asset Backed Securities (ABS) on the one hand and investors in these products on the other. Instead of requiring originators directly to hold 5 % of the net economic interest in their portfolios, the Commission proposed that investors should only be allowed to buy a securitised instrument if the originator had disclosed to them that they would make the retention. To establish a level playing field across financial sectors, the Commission decided not only to impose such requirement on credit institutions that invest in ABS, but also on UCITS funds and insurance undertakings. EFAMA was successful in ensuring that the negotiations on UCITS IV were not jeopardised and delayed by this discussion, and could convince Parliament and Council to deal with this question not in the context of the hastily revision of the CRD, but at a later stage to ensure that the specific characteristics of investment funds would be taken into account when drafting such a provision for UCITS funds.

The Commission now has integrated in its proposal for a Directive on Alternative Investment Fund Managers, published on 30 April 2009, the legal basis which will empower the Commission to adopt implementing measures to impose the new requirements on UCITS at Level 2. Given the highly controversial nature of the new proposal, the rules for UCITS will probably not enter into force in the near future. This gives the industry sufficient time to discuss with EU law makers the exact wording.

4.2.2 The Madoff Affair

BMIS (Bernard L. Madoff Investment Securities, LLC) created in the early 1960s was initially a pure brokerage firm but very rapidly developed into a company which in mid-2008 held $700 million in equity capital and handled about 10% of the NYSE trading volume. Another smaller part of BMIS' business was the management of twenty-three discretionary accounts with $17 billion using the so-called "split-strike conversion strategy" developed by Madoff and promising annual returns of 10% to 12%. Most of these accounts belonged to feeder funds globally marketed by numerous intermediaries or used as underlying assets for structured products etc.

Thanks to this structure, the final investors were not direct customers of BMIS. On the other hand, the feeder funds had to open a brokerage account with BMIS and delegate the full trading authority of their portfolios to BMIS. On 10 December 2008, Madoff confessed that his investment advisory business was a *"giant Ponzi scheme"*. The next day, he was put under arrest.

For the European investment management industry this affair had serious implications:
In many countries UCITS funds, or indirectly funds of funds, were invested in Madoff feeders and some funds lost their assets because of the asset transfer to BMIS and had to be closed. How much money in total was lost through these funds is not yet clear, but immediately a debate started about the robustness of the rules on duties and liabilities of the depositary in the UCITS Directive.

Discussions culminated on 12 January 2009 in a letter from the French Minister for Finance and Economy, Christine Lagarde, to Commissioner McCreevy complaining that Articles 7 and 14 of Directive 85/611/ EEC had been implemented differently among Member States and arguing that this could potentially undermine investors' confidence in the UCITS "label" and that in order to avoid this from happening further harmonisation would be needed.
The letter and its conclusions were discussed by the ECOFIN Council meeting of 20 January 2009 and in late January the Commission published its conclusions, underlining that:

> *"Responsibility of an independent depositary for safe-keeping of fund assets is a cornerstone of the UCITS regulatory framework. The Directive clearly assigns responsibility for asset safe-keeping to the depositary and liability in the event of wrongdoing or negligent performance of its duties. The Commission will take the lead in ensuring that the principles enshrined in the Directive are upheld – starting with a review of how Member States give concrete expression to these provision to identify any practices or provisions that might blur the basic responsibilities foreseen in the Directive. On the basis of that review, the Commission will take the lead in bringing forward any actions needed to codify depositary responsibilities."*

However, recent signals seem to indicate that the Commission itself is not keen to "tighten up" the rules in the UCITS Directive regarding the responsibility of the depositary for safekeeping and the conditions for delegation of custody and would prefer to resort to other means rather than re-opening the Directive to achieve clarification on these issues.

Indeed, the key issue in this discussion is Article 9 of the UCITS Directive stipulating that the depositary is liable to the management company and to the unit holders for any loss suffered by them as a result of its unjustifiable failure to perform its obligations or its improper performance of them, *in accordance with the national law of the fund's home country*. In the same context, Article 16 regulates the depositary's liability for investment companies. Such liability exists with respect to both of the depository's functions, i.e. safekeeping and control, and with respect to investor and fund. However, the Directive does not specify whether the performance of any control duty is subject to an obligation of result (restitution of the assets) or rather to an obligation of means. The Commission seems to be of the opinion that the Directive supports the first interpretation but admits that this point has never been formally confirmed.

All Member States seem to have implemented the general liability principles of the Directive: the depositary is liable to the investor and the fund in case of failure to perform its obligations or in case of improper performance of them. The problem, however, is that according to the Directive the level of liability depends on national law.

EFAMA's position in this discussion has been very clear from the beginning:

- contribute to making the discussion more objective and to putting an end to reciprocal incrimination;
- meet the concerned competent authorities to hear about the progress of their research and to remind them that the issue is urgent as the UCITS brand and investors' trust are at risk;
- underline that investor protection remains EFAMA's top priority;
- draw attention to the fact that the mechanism of the UCITS Directive provides for a high level of investor protection and that it is not yet clear that any investor in a UCITS will lose money;
- support the Commission in its view that a fundamental analysis is needed before discussing new or additional legislation.

In a second step, EFAMA set up a working group (including both fund managers and depositaries) to support these initiatives and to show practical ways forward in developing clear ideas regarding procedures which would reduce or avoid the risk of investors losing money independent of the liability regime under which the depositary acts. These procedures should include rules and industry best practices regarding:

- the relationship between fund/fund manager and depositary: obligations and responsibilities of both parties;
- the responsibility of the depositary vis-à-vis the fund/fund manager in the case of sub-custody;
- the relationship between depositary and sub-custodian.

Only at the end of the discussions should the Group discuss whether or not legal action (modification of the UCITS Directive or CESR Level 2) is needed from the industry's point of view. Should this be the case, appropriate proposals should be made to EFAMA's Board of Directors. Independent of this own initiative, the group must continuously monitor the discussion at EU level.

Regarding the two most frequently cited Luxembourg UCITS, Luxalpha and Herald Lux, in early April the Luxembourg District Court at the request of the Luxembourg authorities (CSSF) ordered their dissolution and winding-up. Liquidators have been appointed and the judgment states that the unit holders shall be considered as shareholders which are entitled to share the surplus of the winding-up.

4.2.3 The "de Larosière Group"

The political debate on the future supervisory architecture for the EU is not new, but it has gained in momentum with the financial crisis. On 9 October 2008, European Parliament adopted a resolution entitled "Lamfalussy follow-up – Future Structure of Supervision" containing concrete proposals for the supervision of large cross-border financial groups, a strengthening of the Lamfalussy Level 3 Committees, financial stability arrangements and crisis prevention. At national level, governments created several expert groups to analyse the reasons for the meltdown and propose solutions. The European Commission followed suit by establishing the High-Level Expert Group chaired by Jacques de Larosière, former managing director of the IMF and Governor of the Banque de France, and composed of a small number of highly skilled and experienced individuals active in financial markets. In particular, the group was tasked to consider:

- how supervision of EU financial institutions and markets should best be organised;
- how to strengthen European cooperation on financial stability oversight, early warning mechanisms and crisis management;
- how supervisors in the EU should cooperate with other major jurisdictions to help safeguard financial stability at global level.

The Group presented its recommendations on 25 February 2009, which were followed by a Commission's Communication on 4 March, "Driving European Recovery", endorsing the proposals made and setting out a road map. The Commission announced the presentation of a European financial supervision package before the end of May 2009, for decision at the June European Council. In order for a renewed supervisory framework to be up and running by the end of 2010, legislative proposals would be submitted in the second half of 2009.

Before setting out its concrete proposals, the Commission undertook a consultation in the spring, lasting only four weeks, to which EFAMA replied. EFAMA strongly supported a harmonised European supervisory framework and welcomed the de Larosière recommendations in this respect. However, members were concerned that the future architecture risked being designed from a purely banking and insurance perspective, thereby ignoring the interests and needs of the asset management industry as an important part of the buy-side. EFAMA further underlined the need for improved banking regulation to restore confidence in financial markets and for strong and coherent European representation at international level.

In parallel to the work undertaken by the de Larosière Group, in January 2009 the Commission put forward two measures aimed at enhancing the Committee of European Securities Regulators (CESR). Firstly, it presented its decision providing a clearer framework for CESR by specifying its tasks (such as facilitating mediation, promoting exchange of information or developing common supervisory standards), reinforcing cross-sector cooperation and by introducing qualified majority voting without, unfortunately in EFAMA's view, changing the non-binding character of any decisions taken.
Secondly, it proposed to fund CESR and the other two Committees out of the Community programme. This proposal is subject to the co-decision procedure and hence needs the approval of European Parliament and European Member States.

Both proposals were preceded by a public consultation in July 2008 in which EFAMA participated. EFAMA members expressed the same concerns as they did later in the context of the de Larosière report, i.e. that the proposed modernisation was approached from a pure banking and insurance perspective and that the securities sector was not sufficiently taken into account. EFAMA further insisted on enhanced cross-sectoral cooperation as well as the streamlining of reporting requirements both in terms of format and content across the three sectors.

5 THE INTERMEDIARIES

Comparatively few European intermediary firms (49 so far) operate cross-border. A handful of Anglo-Saxon IFA groups are working to set up new agent outlets in more than one European country but these tend to be focused on expatriate clientele; the German network OVB (listed on the Frankfurt Stock Exchange) is a notable exception.

Within the EU, there is today only 30 intermediary networks employing approximately 5,000 staff for their front and back office – and grouping more or less 50,000 individual intermediaries.

Intermediary firms have been the targets of large international groups acquiring IFA firms for cash at a multiple estimated to be closed to five times EBT.

The EC has launched consultations to seek the views of the industry and other interested parties on the future regulation of financial conglomerates (i.e. single financial entities that offer a range of financial services such as banking, insurance, fund management and security brokerage together). In the opinion of the EC, the objective of one wholesale financial market and open and secure retail markets cannot be achieved without state-of-the-art prudential rules and supervision.

The phenomenon of financial conglomerates has grown fast and although specific prudential issues are being discussed separately in the banking and insurance sectors, the continuing trend towards closer corporate links between financial institutions across sectors and across borders gives rise to new concerns that require new legislation.

The review of Article 82 on the abuse of dominant position is also keeping EC Directorate General (DG) Competition busy. Comments to its Discussion Paper have shown that there is general agreement that the anti-competitive foreclosure is the main competition concern of discriminatory abuses. Stakeholders recommend an effects-based approach should be applied. Comments though diverge as to whether to create categories of conduct which generally cannot be classified as abuse; how to apply the “as efficient competitor test” in practice; and how to take efficiencies into account.

There is also a general consensus that there should be more emphasis on effective competitive constraints and less on market share. One of the areas of debate amongst stakeholders is whether or not to set special rules for legal monopolies. The EC will prepare draft guidelines on the issues included in the discussion paper, which will be subject to a consultation before adopting the final guidelines.

How to prevent excess of consolidation leading to monopolistic trends which will in turn generate more protectionism?

	NUMBER OF INTERMEDIARIES				POPULATION	
	Individual Intermediaries	Intermediary Companies	Distributors	Others (Lawyers, etc.)	Local	EU expatriates
UK	45,000	3,000	350	50,000	61,100,000	150,000
Benelux	15,000	1,500	200	5,000	27,700,000	100,000
France	3,000	800	150	20,000	62,400,000	820,000
Germany	300,000	7,000	500	200,000	82,060,000	425,000
Italy	35,000	4,000	300	45,000	60,100,000	125,000
Scandinavia	3,000	350	150	3,500	23,000,000	120,000
Spain	20,000	1,200	350	10,000	46,600,000	1,120,000
Switzerland	10,000	860	250	5,000	7,700,000	50,000

	NUMBER OF CONSUMERS BY VALUE OF SAVINGS/INVESTMENTS					
	Less than €10,000	€10,000 to €50,000	€50,000 to 100,000	€100,000 to €500,000	€500,000 to €1,000,000	more than €1,000,000
UK	33%	25%	15%	10%	5%	2%
Benelux	25%	30%	30%	10%	3%	2%
France	30%	30%	20%	10%	3%	2%
Germany	25%	35%	25%	10%	3%	2%
Italy	30%	30%	25%	5%	6%	4%
Scandinavia	15%	25%	30%	25%	3%	2%
Spain	20%	30%	25%	15%	5%	5%
Switzerland	10%	25%	30%	25%	5%	5%

5.1 EU INTERMEDIARIES' ASSOCIATIONS & FECIF MEMBERSHIP

COUNTRY	NAME
Belgium	BzB (Beroepsvereniging Zelfstandige Bank)
	FPFP (vzw Federatie van Persoonlyke Financiele Planners)
	EFIB (Fortis Vlaanderen VZW)
	FEDAFIN (Fédération des Agents Financiers Indépendants Francophones)
France	ANACOFI (Association Nationale des Conseils Financiers)
	CCEF (Compagnie des Conseils et Experts Financiers)
	APECI (Association Professionnelle des Entreprises de Conseils en Investissement)
	ANCDGP (Associaton Nationale des Conseils Diplômés en Gestion de Patrimoine)
	CNCEF (Chambre Nationale des Conseils Experts Financiers)
	AFCGP (Association Française des Conseils en Gestion Privée)
Luxembourg	ALPP (Association Luxembourgeoise des Professionels du Patrimoine)
Germany	VOTUM (Verband unabhängiger Finanzdienstleistungs-Unternehmen in Europa e.V.)
	Deutsche Gesellschaft Für Finanzplanung e.V.
Austria	WKO Die Versicherungsagenten
Switzerland	GSCGI (Groupement Suisse des Conseils en Gestion Indépendants)
Italy	ANASF (Associazione Nazionale Promotori Finanziari)
	NAFOP (The National Association of Fee Only Planners)
Spain	APAIF(Asociación de Profesionales Asesores de Inversión Y Financiación de Catalunya)
	APAIF (MADRID)
	ANAF (Associación Nacional de Agentes Financieros)
Poland	EFFP Polska (European Federation for Financial Professionals Poland)
	FECIF Poland
Czech Republic	AFIZ (Association of Financial Intermediaries and Financial Advisors of Czech Republic)
Slovak Republic	AFISP (Association of Financial Intermediaries & Financial Advisors)
Cyprus	CIFSA (Cyprus International Financial Services Association)

5.2 WHAT IS AN INDEPENDENT INTERMEDIARY?

There are two elements to appreciate if an intermediary is truly independent i.e. in a position to advise his (or her) potential client in total objectivity, neutrality and impartiality.

- his (or her) financial status,
- his (or her) commercial status.

5.2.1 Financial status

If the intermediary is remunerated on a salary basis by a product provider, he (or she) cannot claim being independent as obviously there is a relation of subordination between the product provider and the intermediary.

Similarly, if a product provider controls more than 10% (EU legal definition of a controlling participation – see IMD art.12.1 § c & d) of the intermediary's business or if the intermediary controls more than 10% of the product provider's share capital, in both circumstances, the intermediary cannot claim being independent.

5.2.2 Commercial status

If the intermediary is acting as an exclusive agent for one or more product providers, he (or she) cannot claim, being independent as obviously there is a relation of subordination created by the exclusive agency agreement between the product provider and the intermediary.

With the unique exception of Italy where a tied-agent is authorized to provide financial advice under certain terms when acting on behalf of the firm he represents.

If the intermediary is in a position to select for his (or her) client whatever product and/or service it feels appropriate to recommend, then the intermediary can be considered as being fully independent.

5.2.3 What the EU legislation says?

This is the information that any intermediary authorized to do business within the EU has to provide to his potential client:

- his identity and address,
- the register in which he has been included and the means for verifying that he has been registered,
- whether he has a holding, direct or indirect, representing more than 10 % of the voting rights or of the capital in a given product and/or service provider,
- whether a given product and/or service provider or parent company of a given product and/or service provider has a holding, direct or indirect,

representing more than 10 % of the voting rights or of the capital in the intermediary’s business,

- the procedures allowing customers and other interested parties to register complaints about intermediaries and, if appropriate, about the out-of-court complaint and redress procedures.

- In addition, an intermediary shall inform the customer, concerning the proposal that is provided, whether:

- he gives advice based on the obligation to provide a fair analysis, or

- he is under a contractual obligation to conduct mediation business exclusively with one or more product and/or service providers. In that case, shall he, at the customer's request provide the names of those product and/or service providers, or

- he is not under a contractual obligation to conduct mediation business exclusively with one or more product and/or service providers and does not give advice based on the obligation to provide a fair analysis. In that case, he shall, at the customer's request provide the names of the product and/or service providers with which he may and does conduct business.

In those cases where information is to be provided solely at the customer's request, the customer shall be informed that he has the right to request such information.

When the intermediary informs the customer that he gives his advice on the basis of a fair analysis, he is obliged to give that advice on the basis of an analysis of a sufficiently large number of products and/or services available on the market, to enable him to make a recommendation, in accordance with professional criteria, regarding which product and/or service would be adequate to meet the customer's needs.

Prior to the conclusion of any specific transaction, the intermediary at least shall specify, in particular on the basis of information provided by the customer, the demands and the needs of that customer as well as the underlying reasons for any advice given to the customer on a given product and/or service. These details shall be modulated according to the complexity of the transaction being proposed.

5.3 EUROPEAN DISTRIBUTION DATA

Country	Population (million)	Disposable income (€)	Gross saving rate (%)	Financial saving rate (%)	Debt ratio over disposable income (%)
Germany	82.6	17,694	16.4	8	104.7
UK	61.1	19,239	5.2	-2	116.1
Italy	60.1	15,497	15.8	7.2	34.2
Spain	46.6	11,125	10.6	2.2	82
France	62.4	16,609	16.7	8.8	60.4
Netherlands	16.5	15,020	14.6	1.2	188.4
Belgium	10.6	16,208	16.4	13.1	60.7

(Source: *Le Figaro*)

The estimated breakdown between the type of intermediaries is as follows:

	Tied	Multi-tied	Brokers	FP
Germany	65%	25%	8%	2%
Great Britain	50%	35%	10%	5%
Italy	10%	75%	10%	5%
Spain	50%	35%	9%	1%
Switzerland	30%	40%	20%	10%
Austria	50%	35%	9%	1%
France	40%	35%	20%	5%
Luxembourg	10%	40%	30%	20%
Greece	60%	30%	9%	1%
Baltic states	60%	30%	9%	1%
Netherlands	20%	40%	30%	10%
Belgium	40%	30%	25%	5%
Poland	60%	30%	9%	1%
Scandinavian Countries	50%	30%	10%	10%
Ireland	20%	40%	30%	10%
Cyprus	20%	40%	30%	10%
Portugal	60%	30%	9%	1%
Czech Republic	20%	70%	7%	3%

(Source: *FECIF*)

Intermediaries retained between 20% and 56% of the investment market (distribution of insurance products and services, investment funds, mortgage, etc.) in the major EU member states:

Country	Market share in %
United Kingdom	56%
Benelux	51%
Germany	36%
Scandinavian Countries	35%
Italy	34%
Spain	30%
Poland	25%
Czech Republic	20%

Switzerland	20%

(Source: *FECIF*)

A majority of the EU intermediaries are compensated on a commission-basis. Only few intermediaries are remunerated on a fee-basis.

The EU intermediary community comprises approximately over 500,000 private individuals exercising this profession as a main occupation (representing approximately 20,000 legal entities), and about 300,000 are members of national professional associations (56 at today's count).

Country	Number of IFA's
Germany	300,000
Czech Republic	30,000
Great Britain	45,000
Italy	35,000
Austria	35,000
Spain	20,000
Switzerland	10,000
Belgium	9,000
France	3,000
Luxembourg	3,000
Greece	3,000
Baltic states	3,000
Netherlands	3,000
Poland	3,000
Scandinavian Countries	3,000
Others	30,000
Total	**535,000**

(Source: *FECIF*)

5.4 WHO IS A FINANCIAL ADVISOR?

Financial Advisor

1. Understands the client's financial and personal objectives
2. Reviews the client's needs and circumstances
3. Recommends financial solutions to the client
4. Guides the client in his/her financial dealings
5. Informs on the risk factors and identifies short falls
6. Informs of the immediate consequences of the financial choice/options
7. Keeps in contact with the client and ensures that the finances are in order
8. Reviews the progress in the financial plan
9. Provides financial solution that are relevant, true and fair and appropriate to the client
10. Establishes strategies for the client
11. Provides a service or personal financial planning
12. Communicates, coordinates and reconciles the agreed financial solutions with the client
13. Monitors changes in a client's situation and recognises when the changes are needed in the financial plan
14. Others

Financial Advisor can offer Advice on:

1. Pensions
2. Insurance, Protection/Life and Health Insurance
3. Savings and Investments
4. Banking Products
5. Real Estate
6. Mortgaging
7. Taxation
8. Portfolio Management

Financial Advisor can offer Products from:

1. The whole market, i.e. insurance companies, banking institutions, investment banking, private banking, mortgage institutions, etc.
2. A limited amount of products providers
3. A single product provider or group of products providers

5.5 OTHER PROFESSIONALS PROVIDING FINANCIAL ADVICE (LAWYERS, ACCOUNTANTS, ETC.)

Germany	200,000
United Kingdom	50,000
Italy	45,000
France	20,000
Spain	10,000
The Netherlands	5,000
Switzerland	5,000
Scandinavian countries	3,500
Belgium	2,000
Luxembourg	2,000
Austria	2,000
Portugal	1,500
Greece	1,000
Ireland	1,000
Total	**305,000**

5.6 ADVISERS "OUT OF TOUCH" WITH WEALTHY INVESTORS

IMPORTANT SERVICES FOR WELL-OFF

Question: How much importance do you place on the receiving the following services from your intermediary (Scores are out of 100)

Reporting/Statements	75
Selection of specific investments	70
Market info/research	66
Tax planning	65
Servicing accounts	64
Financial planning	62
Asset allocation	61
Estate planning	59
Trading	56
Trust formation & management	54
Internet access	52
Funding	48

Source: "Investment Adviser"

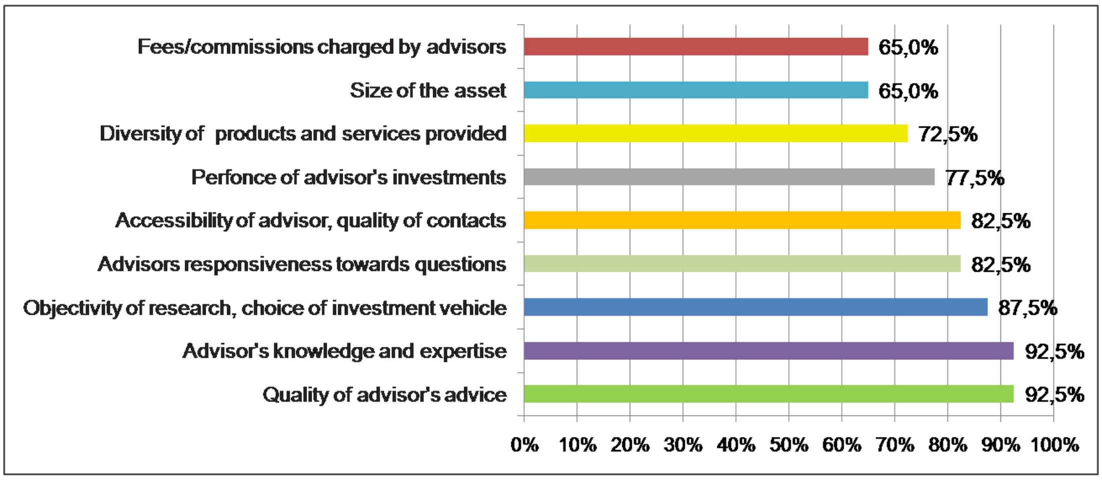
6 THE CONSUMERS

The end customer of the average intermediary is middle class business- and professional who do not manage its own money but is below the levels required for private banking services. Typically it invests between €30,000 and €100,000 as a lump sum to commence a personal pension or a life policy. Often it will have to reinvest the proceeds of a tax-driven investment that has matured.

It often wishes to make additional savings provisions in a tax efficient manner, often wishing to place funds with an international rather than local organization.

We estimate that there is 100,000,000 such type of clients or potential clients in Europe. A large proportion of them mistrust the ability of their government to provide them with a decent retirement.

Consumer/investor's main considerations when choosing a financial advisor



7 THE SUPPLIERS

Over the last 25 years, an increasing number of financial institutions have come to accept the growing importance of cross-border sales activity in Europe.

For some life companies, fund groups or banking institutions, this evolution has led to activities in just one or two target countries (Clerical Medical, Prudential, Skandia, Friends Provident, etc.).

For others, this trend has been more diversified. In recent years, some institutions have gone so far as to establish separate subsidiary companies that have been specifically created to promote and trade Financial Services related products on an international basis (JP Morgan Flemings, Zurich, Aspecta, etc.).

Others have made strategic investments in operations that appear to offer a developing distribution base (Lombard, HSBC).

The EU is an important growth market with high potential. The EU is politically stable with more than 450 million citizens. With a median age of 39 it is the world's highest average age. Pension and health care systems are not well prepared for the continuous changes to come. Millions of people will need additional private pension provisions.

8 THE MARKET

The ageing trend of the EU population will create unprecedented and tough social and business strain. The enterprise sector in general will face the impact of the ongoing ageing of the labour force and the life insurance companies, pension funds and pay-as-you-go schemes with the consequences of the increase in life expectancy.
It should be up to the individual corporation to elaborate its own strategy with reference to the socio-economic circumstances.
However, many issues are common to all market players and the formulation of strategies may be greatly assisted by an exchange of views, a common consideration of scenarios and assessment of the degree of uncertainty of projections.
The EU pensions and personal investment market is undergoing a period of rapid change. The financial pressures of an ageing population combined with governments' needs to cut spiralling welfare budgets are the chief driving forces fuelling the trend towards greater private pension provision.

However, national markets remain fragmented. Cross-border competition is limited by a variety of market entry barriers, reducing consumer choice and hindering flexible business operation and innovation. The volume of cross-border retail business under Freedom of Services (FOS) is still negligible, mainly because of the abusive use of "general good practice" rules by local regulators.

The EU asset management industry manages over € 10 trillion of assets, roughly the size of EU GDP!

Insurance premium represents almost 9% of EU GDP and assets managed by insurers and occupational pension funds are equivalent to over 75% of EU GDP.

The current value of private Pension Funds in Europe is thought to be € 2.82 trillion (Source: *Mercer/FT*), the bulk of which is concentrated in the two largest markets – the UK and the Netherlands.

Over the next decade these funds are anticipated to grow dramatically as governments reduce their dependence upon state "pay-as-you-go" schemes, which rely on the social security contributions of the employed to pay the pensions of the retired.

The economic impact of private Pension Funds cannot be overstated. In several European countries, including Ireland and the Netherlands, the value of domestic Pension Funds exceeds stock market capitalisation. Moreover, in the Netherlands and Switzerland these assets represent over 100% of gross domestic product.

Global demand for pensions will spark growth for investment managers and financial advisers.

Allianz estimate that the European pension market will double within the next 10 years, providing a growth of 7.5% per year.

However, compliance issues and operating (marketing) restrictions across continental Europe which vary from country to country are a serious deterrent to any significant expansion of the cross-border activities.

Country	Population in millions	Value of pension assets (€bn)	Pension assets as a % of GDP	Pension assets per capita (€000's)
Belgium	10,2	24	11%	2
Czech Republic	10,3	5	5%	1
Denmark	5,3	145	84%	27
Finland	5,1	39	35%	8
France	58.0	93	7%	2
Germany	82.0	303	14%	4
Italy	57,4	89	7%	2
Netherlands	15,6	490	127%	31
Norway	4,4	34	233%	8
Portugal	9,9	10	9%	1
Spain	39,3	21	4%	1
Sweden	8,9	110	66%	16
Switzerland	7,1	282	117%	40
UK	59.0	991	77%	17

A figure of € 250 bn has been put on the size of the third-party mutual fund market in France, Germany, Italy and Switzerland alone. In a poll of 800 senior investment executives, sector analysis found that France has the largest fund market in these four countries but is the smallest user of externally managed funds.

Growth in demand for third-party funds is likely to be highest in France and Italy, although previously the highest demand has been in Germany. Assets in external funds are forecast to grow by 20% in these two markets.

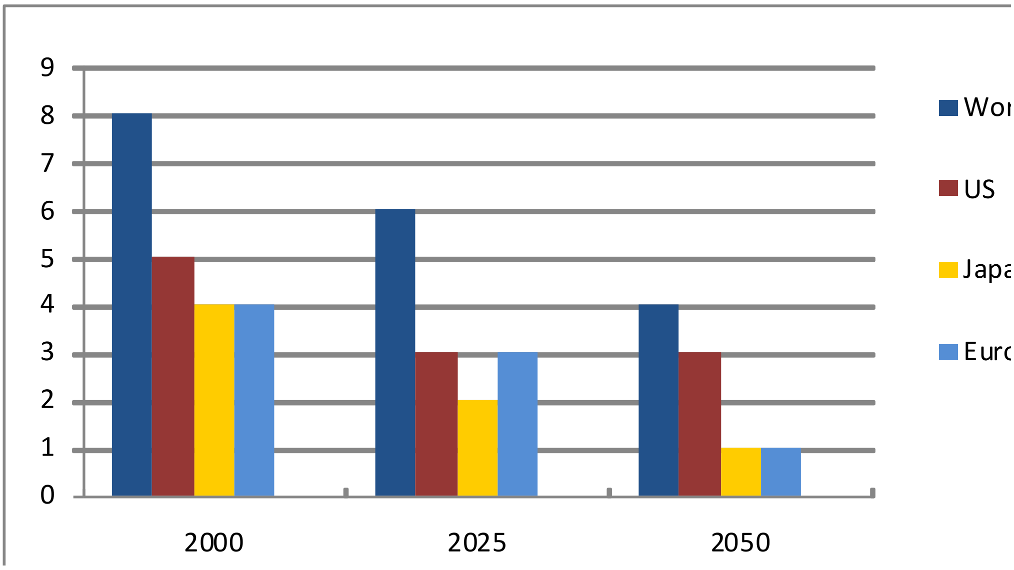
The latest *Annual World Wealth Report* produced by Merrill Lynch shows the global asset management industry for private investors – the famous High Net Worth Individuals (HNWI) – is in good shape and facing a rosy future in terms of growing capital inflows.

The total wealth of the world HNWI is € 18 trillion, up from € 7.2 trillion ten years ago. The market serving rich people grew by 5% and, it is estimated to reach € 23 trillion, with annual growth at 10% within a decade.

Europeans are not only wealthier than ever before but are also living longer, according to a report from Eurostat, the statistical office of the EC. A better standard of living is increasing life expectancy across Europe.

The biggest increase in pensioners is expected in the Netherlands, with the number of over-sixties increasing by 64% compared with 28% in Portugal.

Number of "workers" 65+ year olds



8.1 EUROPEAN INVESTMENT FUND DEVELOPMENTS IN 2008

(Source: EFAMA Annual Report 08/09)

Introduction

2008 was a very difficult year for the European investment fund industry. European investors and fund managers suffered from the worsening of the global financial crisis, which started in the United States in the summer of 2007 to become one of the harshest financial and economic crises in history. Three main factors explain why investment funds were severely hit:

Crisis in financial markets: the massive losses recorded in stock markets across the globe led many investors to pull out record amounts, thereby accelerating the decline in stock prices and equity fund assets. In parallel, the liquidity crisis and the fear of credit and counterparty losses following the bankruptcy of Lehman Brothers led to a breakdown of credit and money markets, which accelerated outflows from bond funds. The difficulties experienced by some money market funds also led many investors in money market funds to redeem their shares in the autumn of 2008.

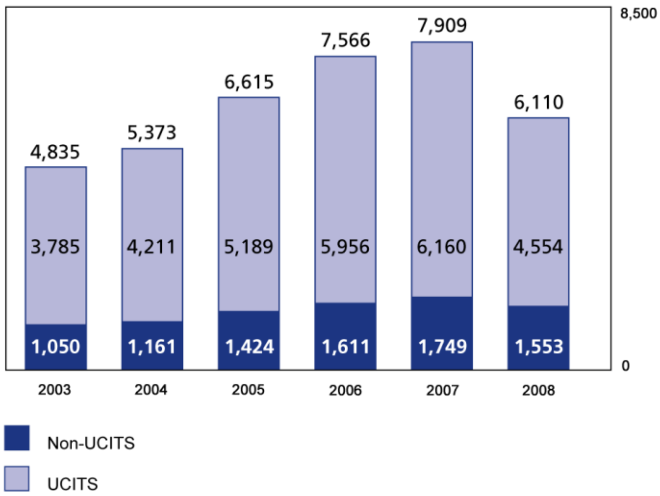
Competition from banks: investment funds continued to suffer from competition from structured products and bank deposits. The war for deposits escalated further when European governments decided to provide guarantees for all bank deposits.

Fear of recession: the worsening of growth prospects for Europe in the second half of 2008 put downward pressure on investor demand for investment funds. This development is in line with our research findings that confirm the importance of stable economic conditions for household demand for investment funds.

The direct consequences of the crisis for the European fund industry can be summarised by the following figures: total investment fund assets fell by 23% in 2008, or €1,799bn, with UCITS recording total net outflows of €344bn, or 6% of UCITS assets at end 2007. It is important to note that net outflows were responsible for only 19% of the UCITS asset decline, while market losses accounted for the remaining 81%. Furthermore, almost 40% of the total outflows from UCITS in 2008 were recorded in the single month of October, when the financial world was on the edge of collapse.

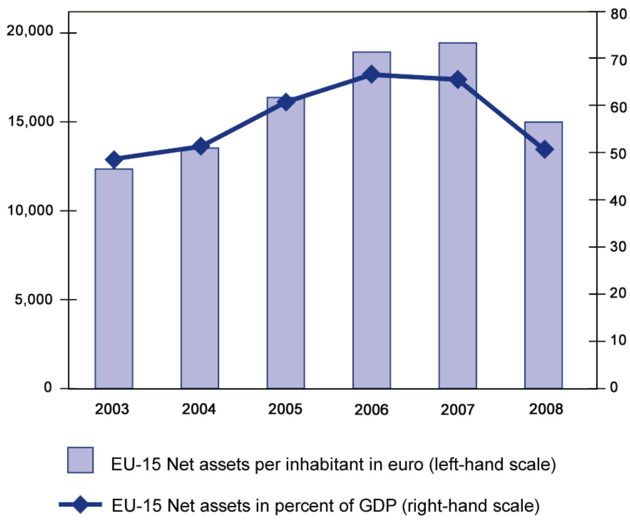
Reflecting these developments, the amount of investment funds per inhabitant dropped in 2008, decreasing for the first time since 2002. Investment fund assets in relation to GDP also decreased significantly in the EU-15 from 66% in 2007 to 51% in 2008.

Chart 1. Net asset of European Investment Funds



Source: EFAMA, EC

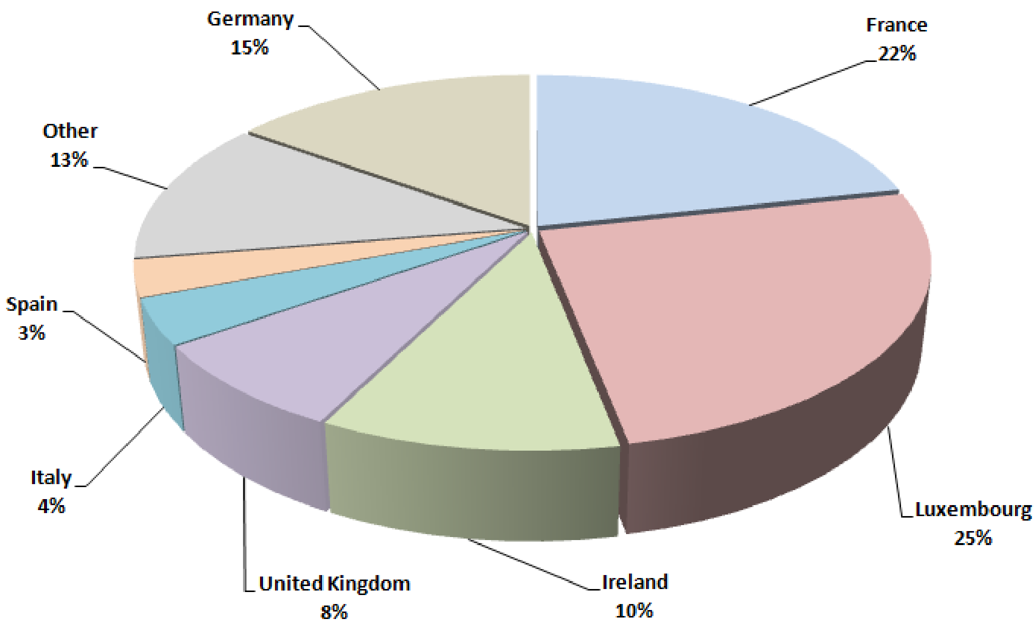
Chart 2. Trends in Investment Funds in EU-15



Source: EFAMA, EC

Three countries – Luxembourg, France and Germany – held a cumulative share of 61.6% of the industry's assets at end 2008. Ireland, the United Kingdom and Italy followed in this ranking (Chart 3).

Chart 3. The European Investment Fund Market
(Breakdown of nationally domiciled funds at end March 2009)

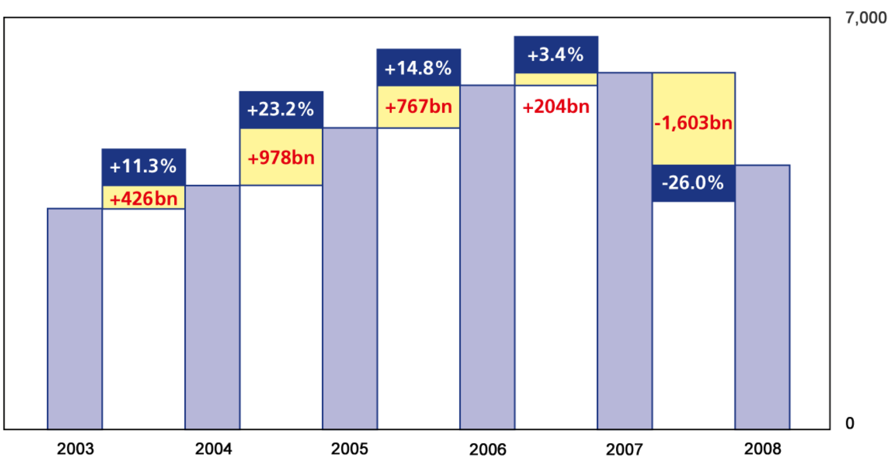


Source: EFAMA

Trends in the UCITS Industry

Total assets in the UCITS2 market declined to €4,557bn at end 2008. Compared with end 2007, total net assets decreased by 26%, or €1,603bn (Chart 4).

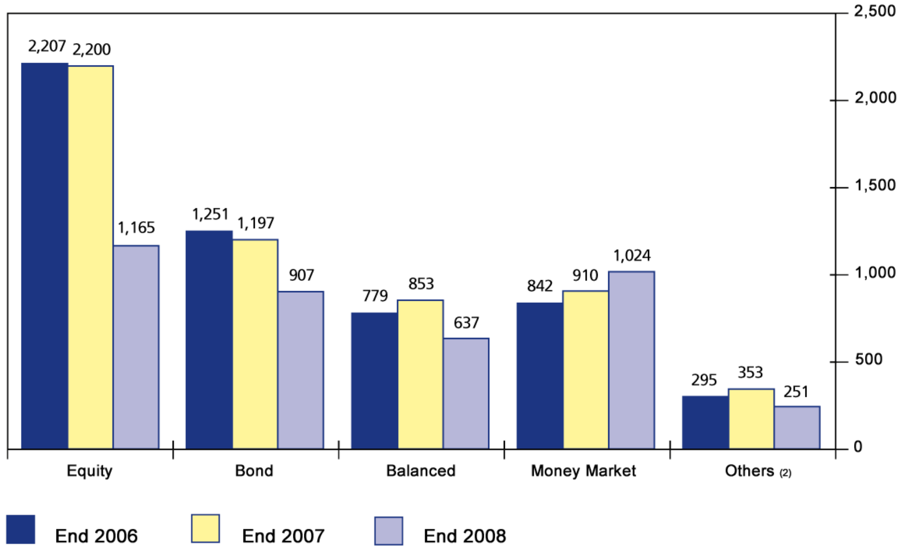
Chart 4. Total Net Assets of UCITS
(EUR billions)



Source: EFAMA

UCITS assets declined in all fund categories in 2008, except for money market funds (Chart 5). Equity funds experienced the highest decline (-47% or €1,035bn), of which 84% can be attributed to market losses. Other fund assets, which include funds of funds, funds of hedge funds and all funds whose strategy falls outside the four main UCITS categories, decreased by 29% followed by balanced funds (-25%) and bond funds (-24%). On the other hand, money market funds enjoyed positive asset growth (13%), benefiting from strong inflows at the beginning of the year, before the worsening of the crisis in money markets.

Chart 5. Net Assets by Type of UCITS(1)
(EUR billions)

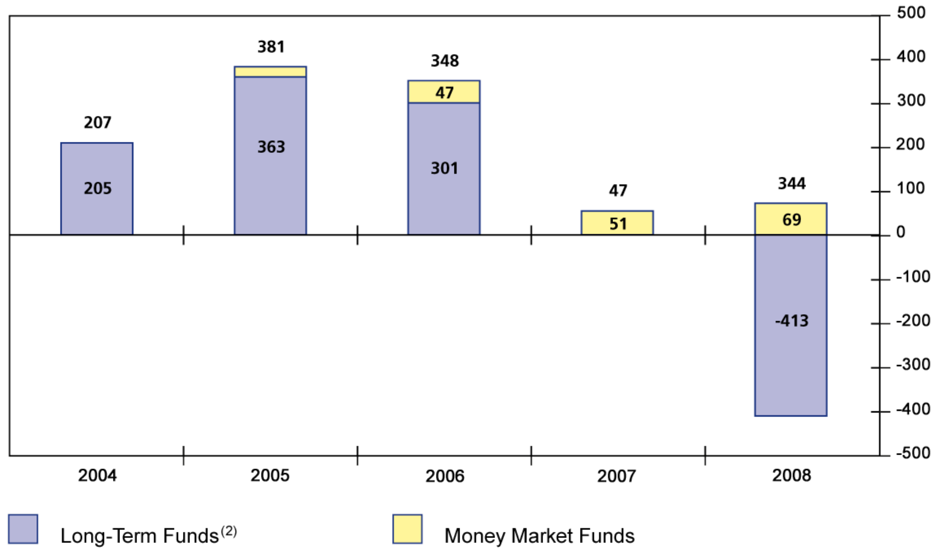


(1) Excluding Ireland and the Netherlands for which no asset breakdown by type of funds is available.
(2) Including funds of funds.

Source: EFAMA

In 2008 UCITS funds experienced outflows amounting to €344bn, with all fund categories registering negative flows except money market funds. The fund industry had never experienced such negative outflows in a single year.

Chart 6. Net Inflows into UCITS(1)
(EUR billions)



(1) Excluding Ireland.
(2) All UCITS excluding money market funds.

Source: EFAMA

Bond funds suffered the strongest outflows in 2008 (€177bn), being mainly affected by the liquidity crisis and the fear of credit and counterparty losses following the bankruptcy of Lehmann Brothers. Equity funds followed with net outflows of €164bn. Balanced funds and other funds also registered net outflows, albeit to a lesser degree. Even if the worsening of the financial crises led to some outflows in September and October 2008, money market funds enjoyed net inflows of €69bn in 2008, confirming their traditional role of safe haven investment in times of market stress. Taking into account inflows into the Irish-domiciled market fund, net inflows are estimated to have reached about €100bn.

Chart 7a. Net Inflows to UCITS
(EUR billions)

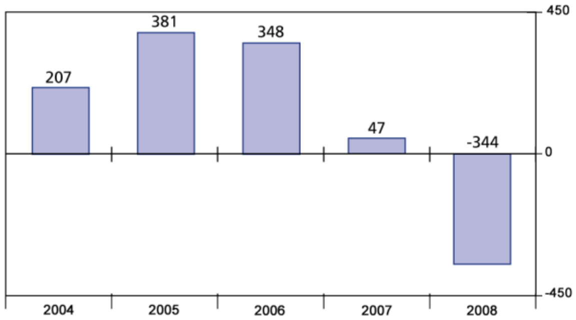


Chart 7b. Net Inflows into Equity Funds
(EUR billions)

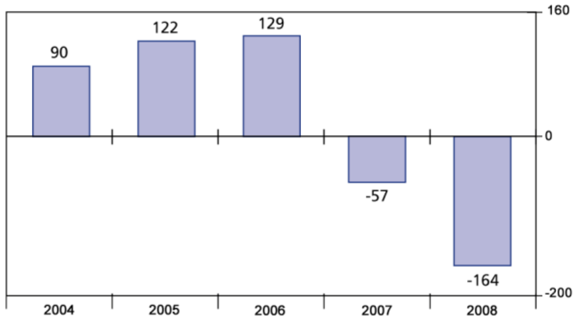


Chart 7c. Net Inflows into Balanced Funds
(EUR billions)

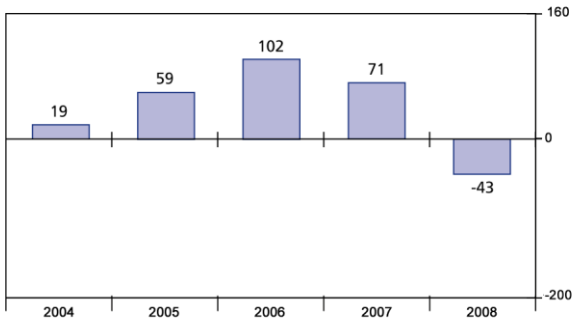


Chart 7d. Net Inflows into Bond Funds
(EUR billions)

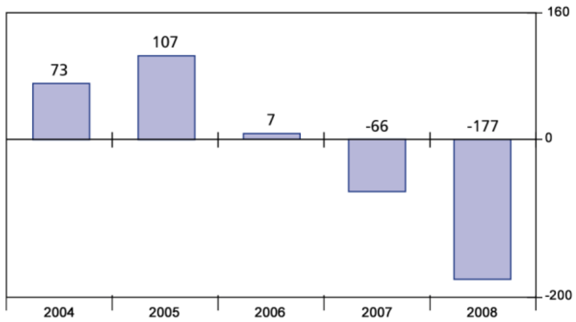


Chart 7e. Net Inflows into Money Market Funds
(EUR billions)

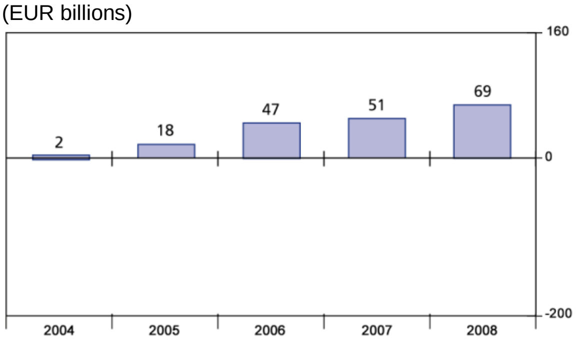
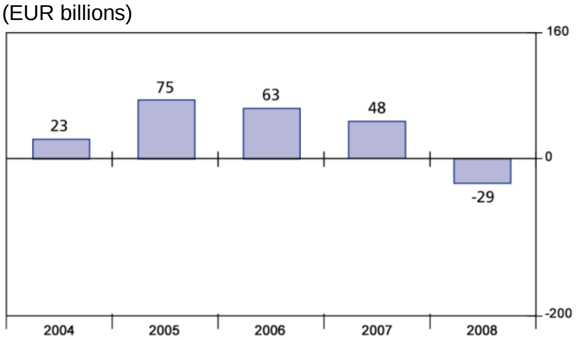


Chart 7f. Net Inflows into Other Funds
(EUR billions)

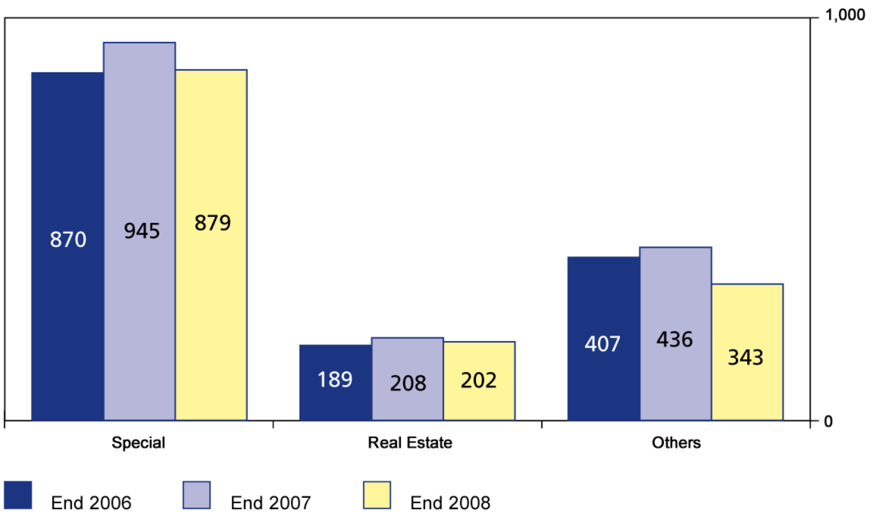


Source: EFAMA

Trends in Non-UCITS Industry

Total assets in non-UCITS decreased by 11.5%, reaching €1,546bn at end 2008. Special funds for institutional investors remained appealing in 2008 (especially low-risk institutional funds), thereby limiting the impact of stock market losses on fund assets. Overall special funds collected €51bn in new money in 2008, compared to €76bn in 2007. Inflows were concentrated in funds domiciled in Luxembourg and Germany.
Assets in real estate funds decreased by 3% in 2008, whereas "other" non-UCITS assets fell by 21%.

Chart 8. Net Assets by Type of Non-UCITS(1)
(EUR billions)



(1) Excluding Ireland for which no asset breakdown by type of funds is available.

Trends across Europe

Looking at net flows in the leading countries, it can be observed that 90% of total net outflows originated from five countries: Luxembourg (€106bn), Italy (73 billion), Spain (€57bn), France (€45bn) and Germany (€19bn). In relation to UCITS assets at end 2007, outflows remained negligible in the United Kingdom (less than 1%), and relatively small in France (3%), Luxembourg (6%) and Germany (7%). In Spain and Italy, net outflows reached considerable levels (21% and 26%, respectively), reflecting strong competition from bank deposits at distribution level.

Elsewhere, outflows reached dramatic proportions in Greece (40%) and Portugal (38%). It is also worth noting that Norway, Romania, Liechtenstein, Sweden and Switzerland recorded positive inflows in 2008.

Net inflows to UCITS in 2008

Country	Net inflows (in EUR bn)	Country	Net inflows (in % of end 2007 assets)
Switzerland	12.4	Romania	32.3
Sweden	2.9	Switzerland	10.4
Liechtenstein	1.4	Liechtenstein	7.7
Romania	0.1	Sweden	2.2
Norway	0.0	Norway	0.1
Bulgaria	-0.1	UK	-0.2
Slovenia	-0.3	Netherlands	-3.3

Slovakia	-0.9	France	-3.3
Czech Republic	-1.2	Poland	-4.4
Poland	-1.4	Denmark	-4.7
UK	-1.4	**EUROPE**	**-5.4**
Hungary	-1.7	Luxembourg	-5.8
Netherlands (*)	-2.6	Germany	-7.0
Denmark	-3.3	Belgium	-7.1
Finland	-7.9	Slovenia	-10.4
Portugal	-8.2	Austria	-12.9
Belgium	-8.5	Finland	-14.3
Greece	-8.8	Hungary	-17.4
Austria	-14.4	Czech Republic	-18.3
Germany	-18.6	Spain	-21.2
France	-44.9	Slovakia	-23.0
Spain	-57.2	Bulgaria	-23.6
Italy	-73.3	Italy	-25.7
Luxembourg	-106.0	Portugal	-38.0
EUROPE	**-343.7**	Greece	-40.5

(*) Net Sales for Q1-Q3 only

Source: EFAMA

Among the fund industry leading countries, Luxembourg, Italy, Spain and the United Kingdom recorded the strongest decline in investment fund asset in 2008, in the range of 24% to 39%. For the United Kingdom, 50% of the decline can be attributed to the depreciation of the pound sterling against the euro. In Ireland and France, the drop in assets was limited to 20% and 14%, respectively, thanks to the importance of the money market fund industry in these countries. By way of illustration, French domiciled money market funds saw their assets increase by €58 billion in 2008, or 13%. In Germany, the high share of special funds contributed to limit the total fund asset decline to 13%.

The Nordic countries also suffered seriously from the crisis in 2008, experiencing a fall in assets in the range of 26% to 42%. The traditionally high equity exposure in those countries explained these developments. It is worth noting that Norway and Sweden were the two most severely hit countries, even though these countries did not record net outflows.

In Central Europe, Bulgaria, Poland and Slovenia suffered a fall in net assets ranging from 54% to 62%, which reflected the high proportion of their balanced and equity funds that characterises the investment fund industry in these countries. Although the Czech Republic and Hungary had recorded an asset decline of only 5% in January-September 2008, these countries were severely hit by the worsening economic crisis in October 2008. Elsewhere, the drain from UCITS to banking products badly affected the fund industry in Portugal and Greece, which saw their UCITS assets fall to around €10bn.

Net inflows to UCITS in 2008

Country	Net inflows (in EUR bn)	Country	Net inflows (in % of end 2007 assets)
Switzerland	12.4	Romania	32.3
Sweden	2.9	Switzerland	10.4
Liechtenstein	1.4	Liechtenstein	7.7
Romania	0.1	Sweden	2.2
Norway	0.0	Norway	0.1
Bulgaria	-0.1	UK	-0.2
Slovenia	-0.3	Netherlands	-3.3
Slovakia	-0.9	France	-3.3
Czech Republic	-1.2	Poland	-4.4
Poland	-1.4	Denmark	-4.7

UK	-1.4	**EUROPE**	**-5.4**
Hungary	-1.7	Luxembourg	-5.8
Netherlands (*)	-2.6	Germany	-7.0
Denmark	-3.3	Belgium	-7.1
Finland	-7.9	Slovenia	-10.4
Portugal	-8.2	Austria	-12.9
Belgium	-8.5	Finland	-14.3
Greece	-8.8	Hungary	-17.4
Austria	-14.4	Czech Republic	-18.3
Germany	-18.6	Spain	-21.2
France	-44.9	Slovakia	-23.0
Spain	-57.2	Bulgaria	-23.6
Italy	-73.3	Italy	-25.7
Luxembourg	-106.0	Portugal	-38.0
EUROPE	**-343.7**	Greece	-40.5

(*) Net Sales for Q1-Q3 only

Source: EFAMA

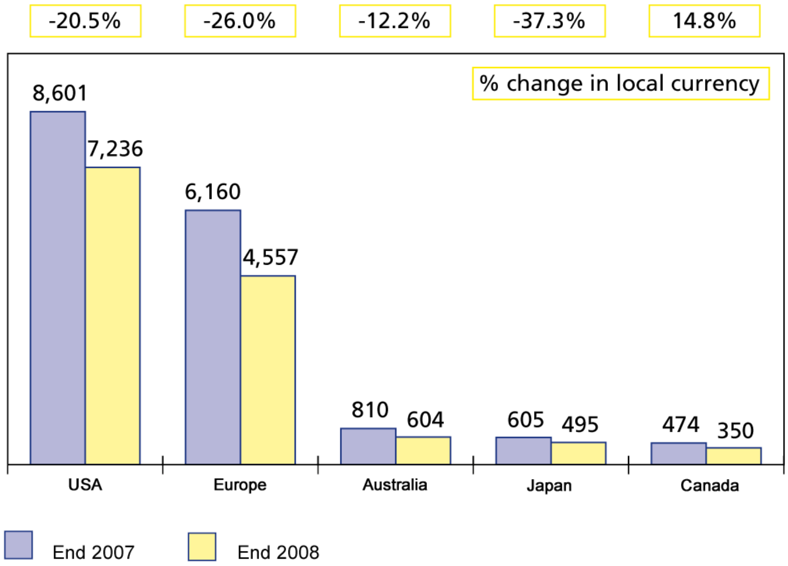
Trends in Worldwide Investment Fund Assets

Worldwide investment fund[3] assets under management decreased by 21% in 2008 to €14,336bn. Measured in U.S. dollar terms, fund assets decreased by 25% to $19,947. Measured in local currency and taking into account funds of funds, U.S. mutual fund assets declined by 20.5% (Chart 10). The other markets in the world also showed negative growth with a 37% decrease in Japan, reflecting a significant fall in equity funds and funds of funds assets.

[3] In the sense of publicly offered open-ended funds, i.e. UCITS in Europe and mutual funds in the United States, including funds of funds.

Chart 10. Trends in Worldwide Investment Fund Assets

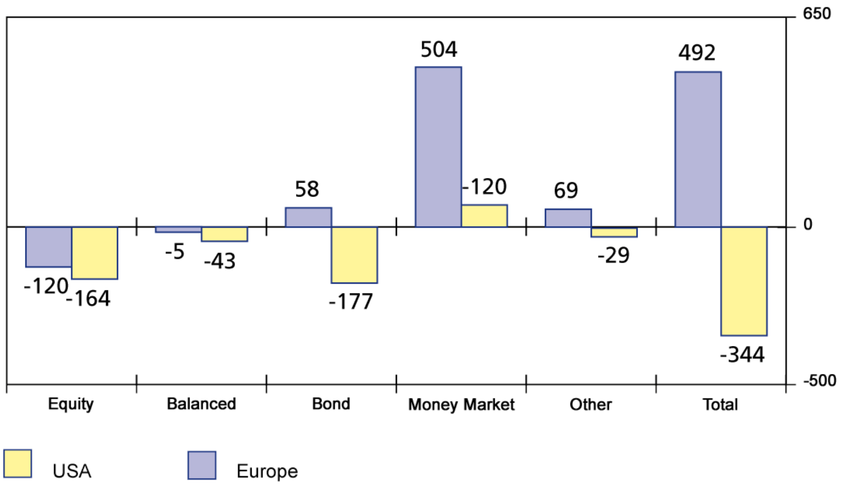
(EUR billions)



Source: EFAMA, ICI

Worldwide net inflows into investment funds reached €236bn in 2008, with the United States attracting €492bn, compared to €344bn outflows in the Europe (Chart 11). Important net flows into money market funds in the United States (€504bn) in 2008, as well as the resilience of bond funds to the crisis, explained the contrasted development on both sides of the Atlantic.

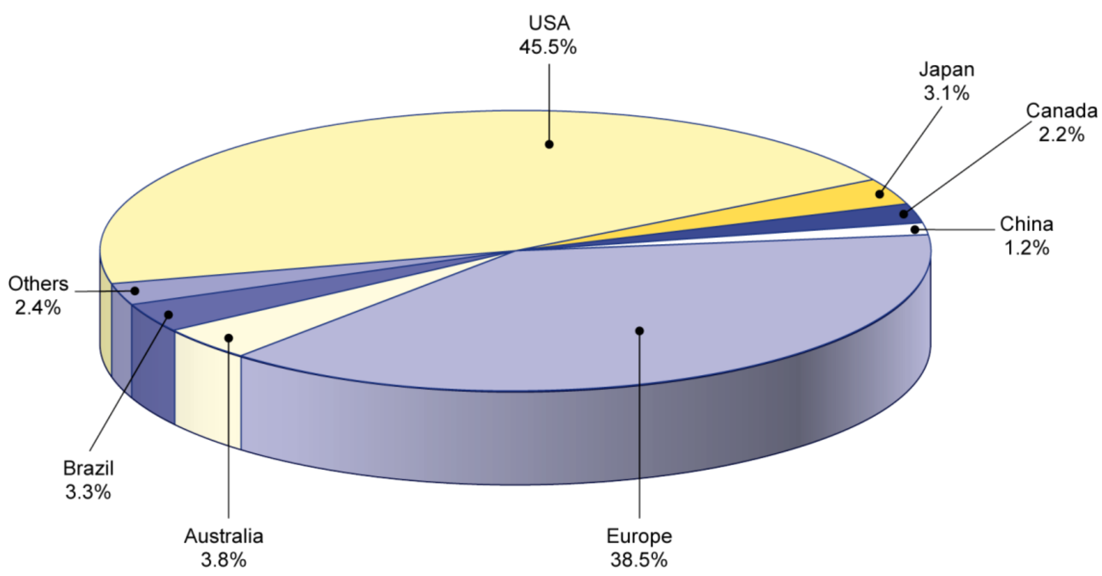
Chart 11. Net Cash inflows to Investment Funds in 2008
(EUR billions)



Source: EFAMA, ICI

Looking at the worldwide distribution of investment fund assets, the United States and Europe held the largest share in the world market, with 50% and 32% respectively at the end of 2008. Australia, Brazil, Japan, Canada and China followed in this ranking. Taking into account non-UCITS assets, the market share of Europe reached 38.5%, compared to 45.5% for the United States (Chart 12).

Chart 12. Worldwide Investment Fund Assets[(1)]
(Market share at end of fourth quarter)



[(1)] Taking into account non-UCITS.

Source: EFAMA, ICI

8.2 EU PENSION AND INVESTMENT MARKET

The ageing trend of the EU population will create unprecedented and tough social and business strain. The enterprise sector in general will face the impact of

the ongoing ageing of the labour force and the life insurance companies, pension funds and pay-as-you-go schemes with the consequences of the increase in life expectancy.
It is up to the individual corporation to elaborate its own strategy with reference to the socio-economic circumstances. However, many issues are common to all market players and the formulation of strategies may be greatly assisted by an exchange of views, a common consideration of scenarios and assessment of the degree of uncertainty of projections.
The EU pensions and personal investment market is undergoing a period of rapid change. The financial pressures of an ageing population combined with governments' needs to cut spiraling welfare budgets are the chief driving forces fuelling the trend towards greater private pension provision.

However, national markets remain fragmented. Cross-border competition is limited by a variety of market entry barriers, reducing consumer choice and hindering flexible business operation and innovation.

The volume of cross-border retail business under Freedom of Services (FOS) is still negligible, mainly because of the abusive use of "general good practice" rules by local regulators.

This report contains detailed description of the characteristics of three types of retail investment products: **i) investment funds; ii) unit-linked life insurance products; and iii) structured notes**.

8.2.1 2009 Report on Market Developments by CEIOPS
(Committee of European Insurance and Occupational Pensions Supervisors)

This report represents a general overview of the developments in cross-border arrangements of Institutions for Occupational Retirement Provision (IORPs), following the implementation by Member States of Directive 2003/41/EC[5]. This is the third report in a series on Market Developments[6] and shows the growth in the number of cross-border IORPs[7], as formally notified to Member States during the period June 2008 – June 2009.

1. The process adopted

Member States were invited to provide an update on cross-border activity during the period June 2008 to June 2009. The update asked for a report on new cross-border IORPs homed in their territory, including descriptive data such as benefit type – either Defined Benefit (DB) or Defined Contribution (DC), and the number of members and beneficiaries involved in the cross-border arrangement. Respondents also reported on any new host state activity of existing cross-border IORPs and on whether or not any established IORPs had withdrawn from previously reported cross-border activity.

2. The findings

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[5] Directive 2003/41/EC is on the Activities and Supervision of Institutions for Occupational Retirement Provision
[6] For 2008 report see CIEOPS–03/07
[7] The IORP Directive requires all new cross-border arrangements to be taken into the notification process, including the situation where an IORP already operating a cross-border arrangement, wants to extend its cross-border arrangement into another sponsoring employer and/or host state.

Table A (below) shows the changes to previously reported cross-border IORPs and new notifications received during the period June 2008 to June 2009. Table B updates the table published in previous reports and summarises responses showing the identity of home and host states and the number of cross-border IORPs. As noted in the report last year, Member States have adopted different approaches as to how they identify a cross-border arrangement and therefore some care must be taken in reaching conclusions relating to home and host state activity and making comparisons between states. Nevertheless, this report continues to facilitate the tracking of individual states' cross-border activity over time and provides a view of the overall level of activity across the EEA.

2.1 Overall results

The results of the 2009 survey show that during the period from June 2008 to June 2009 a total of 10 new cross-border IORPs have been reported. This represents an increase of 14% on the total number of cases (70) reported in 2008.

However, the results also show the cessation of cross-border activity by 4 IORPs during the reporting period. The 4 authorities that reported a full withdrawal are represented in Table A. These are Austria, Finland, Luxembourg (CAA) and Portugal. Information on withdrawals is only presented where the Member State Competent Authority has been formally notified of a withdrawal and the full procedures for withdrawal have been undertaken by the IORP in question. The requirements for this may vary from state to state.

So in total the increase is from 70 to 76 cases, representing a 9% uplift. The results therefore show a modest increase in cross-border activity. This is in comparison to a 46% increase reported in the last report.

2.2 Home activity of Member States

The reported number of home states last year was 9. This year, 4 states reported new cross-border IORPs - Ireland, Liechtenstein, Luxembourg and the United Kingdom, but activity has ceased in 2 home states (Finland and Portugal).

So, the number of home states has not increased due to new activity, but has in fact decreased because of the reported withdrawals. This reduces the total number of home states from 9 to 7.

2.3 Host activity of Member States

In relation to acting as the host state, we see greater levels of diversity compared to home state designation. Last year we could point to 21 states that are acting as a host state for some IORP members. With the reporting of the new cross-border IORPs, 2 new host states enter into the cross-border arena: Hungary and Romania. The withdrawal of some cross-border arrangements mean that 1 state moved out of host activity: Slovenia. This means that the total number of host states is now 22, and continues to give a good spread of cross-border reach across the EEA territory.

2.4 New data

We also asked whether schemes were entering into a DB or DC arrangement. It is well understood that within the EU generally, there are varying definitions for these different types of scheme design. However we wanted to see if new cross-border IORPs followed the general trend across the EEA of favouring DC arrangements. This in fact is the case, with the majority of the new cross-border IORPs reporting that they are of the DC type.

In relation to the number of members and beneficiaries, not all the new cross-border IORPs can give an actual figure but where a response was given, the numbers range from 0 – 350.

Where a withdrawal was reported, we asked the Member State Competent Authority to give an indication as to the reasons for this. We specifically sought market or IORP related reasons but where a response to this was given, the reason for withdrawal seems to be internal to the IORP – for example relating to structure and to negotiations with the sponsoring undertaking. Changes in key personnel within the IORP are also mentioned as a possible reason for the withdrawal of the activity and one State reports that the Member States concerned in the withdrawal could not agree on whether the prudential or the social labour laws applied in respect of the calculation of the minimum guarantee.

3. Next steps

This report will be made available to market participants via the CEIOPS website. CEIOPS intends to continue to seek an understanding of market developments in this area and will be updating this data in 2010.

Table A – New cross-border IORPs and withdrawals of existing cross-border IORPs

Home Country	Host Country	Number of new IORPs	Number of withdrawals
Austria	Germany, Slovenia		1
Finland	Estonia		1
Ireland	The Netherlands, United Kingdom	1	
	Hungary, Poland, United Kingdom	1	
	Luxembourg	1	
Liechtenstein	Germany	1	
Luxembourg (CAA)*	France, Romania, United Kingdom	1	
	United Kingdom, The Netherlands, Germany, France, Poland, Austria, Belgium, Italy, Spain, Sweden		1
Portugal	United Kingdom		1
United Kingdom	Ireland	1	
	The Netherlands	1	
	Germany	1	
	France	1	
	Austria, Germany, Ireland	1	
Total		**10**	**4**

Table B – Overview of reported cross-border IORPs

Home Country	Host Country	Number of cases as at January 2007	Number of cases as at June 2008	Number of cases as at June 2009
Austria	Germany		1	1
	Germany, Liechtenstein		1	1
Belgium	Luxembourg		4	4
Germany	Luxembourg	1	2	2
	Austria	1	1	1
Ireland	United Kingdom	18	21	21
	Belgium	1	1	1
	The Netherlands, United Kingdom			1
	Hungary, Poland, United Kingdom			1
	Luxembourg			1
Liechtenstein	Germany		1	2
Luxembourg (CSSF)**	Finland, Denmark, Estonia		1	1
	The Netherlands		1	1
Luxembourg (CAA)	France, Romania, United Kingdom			1
United Kingdom	Ireland	11	14	15
	The Netherlands	3	3	4
	Belgium		1	1
	Greece	1	1	1
	Germany	2	2	3
	Germany, Austria		1	1
	France, Poland	1	1	1
	France, The Netherlands	1	1	1
	France, Sweden, Spain, Poland	1	1	1
	France, Luxembourg	1	1	1
	Czech Republic, France, Luxembourg, The Netherlands	1	1	1
	Germany, Slovakia, Sweden	1	1	1
United Kingdom (continued)	Belgium, Ireland, Italy	1	1	1
	Bulgaria		1	1
	Ireland, The Netherlands, Germany		1	1
	Ireland, The Netherlands, Spain	1	1	1
	France			1
	Austria, Germany, Ireland			1
Austria	Germany, Slovenia		1	(W)
Finland	Estonia	1	1	(W)
Luxembourg (CAA)	United Kingdom, The Netherlands, Germany, France, Poland, Austria, Belgium, Italy, Spain,	1	1	(W)

	Sweden			
Portugal	United Kingdom		1	(W)
Total		**48**	**70**	**76**

* CAA - Commissariat aux Assurances
** CSSF - Commission de Surveillance du Secteur Financier

8.2.2 Workplace pension provision – mandatory schemes

The value of mandatory private pension arrangements is estimated end 2007 at **€293,60 bn**. From our March 2009 survey we conclude that mandatory pension funds assets have dropped only 10% in 2008 and stands end 2008 at € 265 bn. This is due to their investment profile by which they allocate their assets primarily in fixed income and domestic currency.

8.2.3 Workplace pension provision – voluntary schemes

At the end of 2007, the value of voluntary funded pension arrangements accessed through paid works is estimated at € 4.302 bn.

According as to how the 2nd pillar pension market is organized and structured in the Member States, several vehicles are used: pension funds, book reserves and life insurance companies

At the end of 2007:

€ 3.094 bn was managed by pension funds
€ 289,0 bn was managed by book reserve systems
€ 888,0 bn was managed by life insurance companies*

*(this figure is likely to be under-estimated as not all EFRP Members were able to report or estimate the assets held by life insurance companies for the future workplace payments, nor is there aggregate data available at EU level on assets held by life insurers to back workplace pensions.)

bn. €	Sector		Pension Funds		Group-insurance		Book reserves	
	2006	2007	2006	2007	2006	2007	2006	2007
Austria	23,040	23,500	12,5600	13,0000	1,3000	1,3000	9,1800	9,2000
Belgium	48,890	50,900	14,2000	14,9000	34,6900	36,0000		
Denmark	165,700	185,100	59,7000	61,1000	106,0000	124,000		
Finland	19,530	20,4000	5,5300	5,9000	14,0000	14,5000		
France	150,000	154,000						
Germany	416,300	428,700	135,2000	139,2	47,0000	48,41	234,10	241,09
Irland	78,930	86,600	78,9300	86,6000				
Italy	51,480	57,769	42,2900	48,4620	3,6400	5,7900	4,5500	3,5170
Netherlands	780,000	853,000	690,0000	763,0000	90,0000			
Portugal	8,690	8,346	8,6900	8,3469				
Spain	98,320	51,430	55,8000	58,929	31,0200		11,5000	20,2700
Sweeden	160,480	165,000	12,46000	12,820	133,0800	137,072	14,9400	15,1000
UK	1.557,000	1.490,000	1.423,000	1.490,000	134,0000			
Total (EU-15)	3.558,3600	3.633,534	2.539,36	2.702.258			247,27	289,17
Iceland	1,620	1,668	1,6200	1,668				
Norway	98,000	100,940	23,0000	23,690	75,0000	77,250		
Switzerland	549,740	566,191	355,850	366,525	193,8900	199,666		
Total	**4.207,7200**	**4.302,469**	**2.919,83**	**3.094,139**			**274,27**	**289,17**

red: vehicle not used in Member State
Source: EFRP (European Federation for Retirement Provision) Annual Report 2008

8.2.4 The EU Monetary Union.

Post Euro-phoria, the consensus among government experts' bankers is that there will be a massive shift out of US-dollar-denominated securities. JP Morgan Flemings expects that within five years private investors in non-European countries will have switched €750 bn to €1 trillion out of dollar securities into Euro-based financial instruments.

8.2.5 Developments in pension funds.

There is no coherent pension "market" as such in Europe. The three Pillar system of pension provision is widely used, but each country has a different balance between state and private provision. This means that the threat of the demographic time bomb – the impact of any depopulation on state welfare systems – varies considerably from country to country.

The greatest problems arise in countries such as France and Italy which have very generous state pension retirement scheme and underdeveloped private pension markets.

Germany also has a serious pension problem with the state scheme being in deficit. In several central and Eastern European countries, the switch from under funded state schemes to private funding plans has been swift and dramatic. (Source: *Financial Times: "The Future for European Pensions"*)

There are some signs of demand from multinationals for a Pan-European pension scheme. However, despite the single market's achievements in terms of free movement of persons, goods, services and capital throughout the Union, pension schemes have continued to operate mainly on a domestic basis.

There are attempts to bring forward the possibility of fully portable EU pensions. The first development has been the Directive on supplementary pensions which technically came into effect on 25 July 2001.

The market is keenly aware of the sales potential of pan-European pensions. Luxembourg announced that it is establishing two new vehicles, which will be virtually tax-free and have a totally flexible structure.

Austria

Austria's pension system is thought to be one of the world's leaders in terms of pension expenditure, not because of its demographic structure but because of the generosity of the system. Contributors can obtain an average of 80% of their 15 best years of income as a pension.

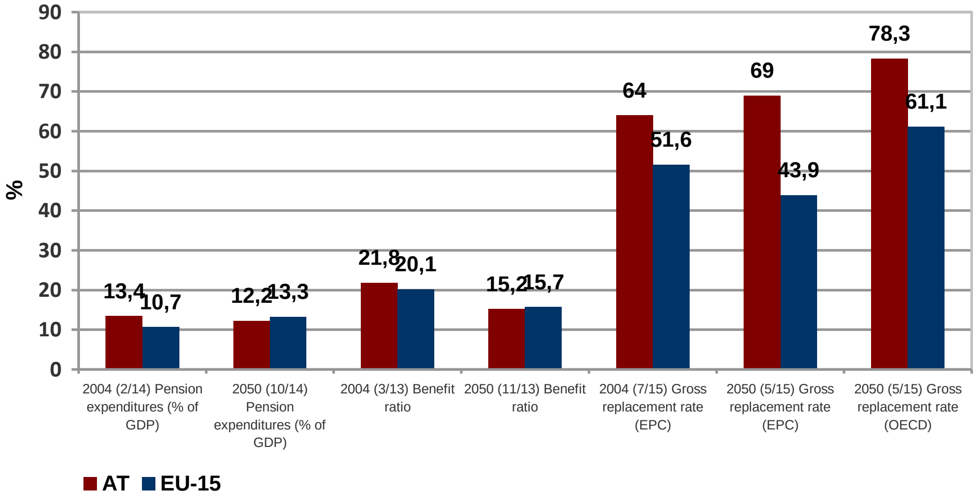
Therefore, pension expenditures absorb 15% of GDP and contribution rates are among the highest in Europe.

The Intermediary's market is growing in importance (35,000 individuals) and a form of co-regulation is in place.

Intermediaries are likely to take some of the distribution market from product providers in Austria.

- Banks holds 55% of life and pensions distribution in Austria
- Banks and insurance company sales forces are set to lose market share.

Indicators on the Generosity of Pension System for Austria and the EU-15 (2004 and 2050)



Source: OeNB calculations based on EPC (2006, tables 3.3; 3.11 and 2.2 (Anex)) and OECD (2005a, table 4.1).

Note: The figures in parenthesis give the rank of the Austrian value among the EU-15 Member States. The OECD calculations show the pension entitlements of a worker who enters the system in 2005 at the age of 20 and retires at the standard pension-eligibility age. Thus, the first year of retirement might vary between 2045 (if the standard eligibility age is 60) and 2050 (if it is 65).

Belgium

Belgian Pension Funds are expected to benefit from an overhaul of the country's pension laws. These changes are likely to result in the relaxation of the legal obligations and bring state pension provision in line with EU legislation.

There are currently approximately 8,000 intermediaries operating in Belgium: 60% are distributing insurance and banking products, they control 60% of the general insurance market and 75% of the investment market.

Belgium is a rich country with 1,4 millions people having net assets between € 50,000 and of € 300,000, and 160,000 in excess of € 300,000. (Source: *De Morgen - 2006*)

Banks will continue to hold nearly half the distribution market in Belgium.

- Banks hold half the market for life and pensions distribution in Belgium
- Bancassurers sold €5.2bn of life and pensions in 2002
- Banks and brokers will lose market share by 2009

Czech Republic

The ageing Czech population will be one of the most obvious in whole Europe in the coming decades. Public pension expenditures are expected to increase by a half from current 8 % of GDP to more than 12 % by 2050. The public PAYG system has therefore to be reformed urgently.

However, only parametric changes are being gradually implemented (the last amendment of the law came into force on January 1st, 2010). The Czech Republic is thus one of the last new EU member states that are still missing a fundamental pension system reform.

There are presently about 50,000 intermediaries registered in the Czech Republic, we estimate that approximately 60% of them (30,000 individuals) are dedicated to their job on a full time basis.

Denmark

Danish insurers are unlikely to maintain their tight grip on life and pensions distribution.

- Insurance sales forces are the most important distribution channel in Denmark
- Danish insurance company employees sold €1.2bn of the life and pensions in 2003
- Danish insurance sales forces are set to lose 8% of the life and pensions distribution market.

Finland

The majority of life and pensions distribution in the Finish market will continue to be controlled by the product providers.

- 70% of life and pensions distribution in Finland goes through banks and insurers
- The total life and pensions market in Finland is small at only €750m
- Bancassurance is set to become the biggest distribution channel by 20096f.

France

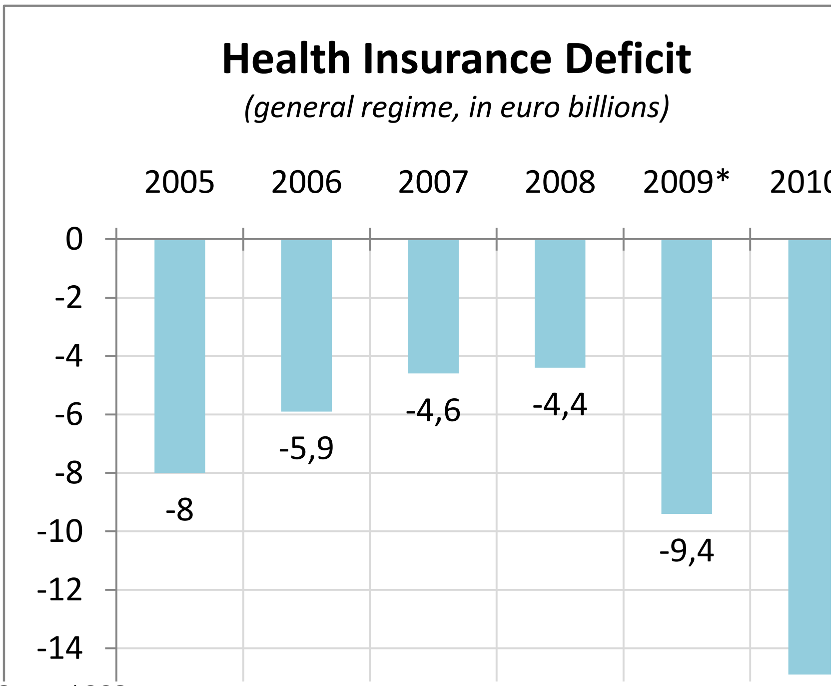
The French state pension scheme faces major challenges in a country with a growing retired population (1/3 of the total population is over 50… controlling 60% of tangible assets) and public commitments in respect of civil servants pension schemes in excess of € 850bn... It is a highly sensitive political issue that may not be solved for some time and this is leading many individuals to make their own independent pension arrangements.

There are presently only a few intermediaries that are properly operating in France. The intermediary community is growing slowly with around 1,300 really active professionals in a total of 4,000 officially registered intermediaries. Few of these appear willing to embrace “foreign” products.

France, it is also 500 asset management firms, 5 of them ranking amongst the 25 biggest management companies worldwide. There is 8,000 UCITS funds and 3,500 non-UCITS funds registered in France managing € 1,5bn. (Source: *Association Française de la Gestion Financière)*

French bankassurers will not be able to maintain their market share growth to 2009.

- Banks dominate life and pensions distribution in France
- €38bn of new life and pensions premiums were sold in France in 2003
- Independent financial advisers will make the biggest gains in the French life and pensions market by 2009
-



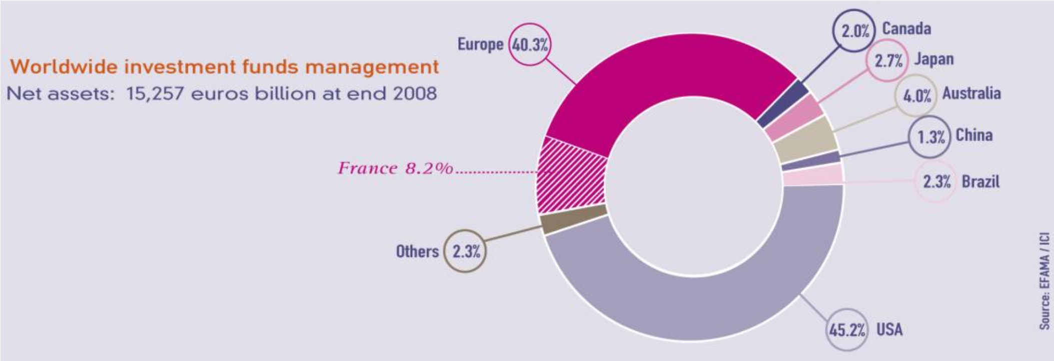
Source / CCS

- Hospital and Clinics expenses (2004-2009*) : ▲ **+18.5%**
- Independent Doctors expenses (2004-2009*) : ▲ **+17.5%**

* forecast

The French Asset Management Industry
(Source: AFG (Association française de la gestion financière) July 2009)

The total size of the worldwide asset management industry (investment funds and discretionary mandates) reaches around €35 trillion worldwide, including around €14 trillion for Europe. Its European fund component reaches €7.4 trillion, to be compared to a similar amount for the USA.



The French asset management industry: The right balance between financial innovation and savers' protection

The French asset management industry is **one of the largest in the world**, with more than **€2,400 billion** of assets managed at end of May 2009. For investment funds, **France ranks 1st in Europe and 2nd in the world as a location for fund financial management** (and not the mere domiciliation), after the USA.

Despite the financial market turmoil, French asset under management average growth remains two digits over the past 10 years, while the **number of French asset management companies has nearly doubled** - from 300 in 1997 up to more than 560 today.

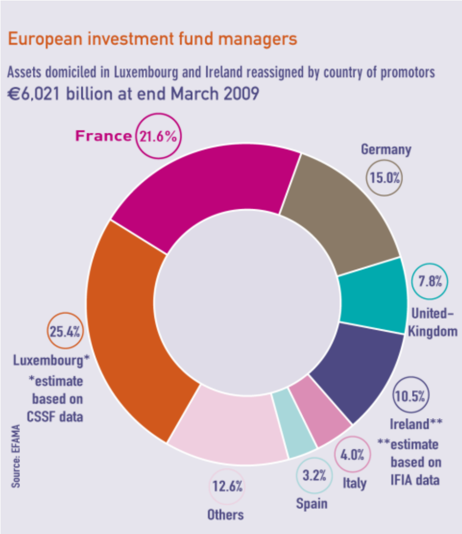
The French industry has gradually built **an efficient and competitive model** based on:

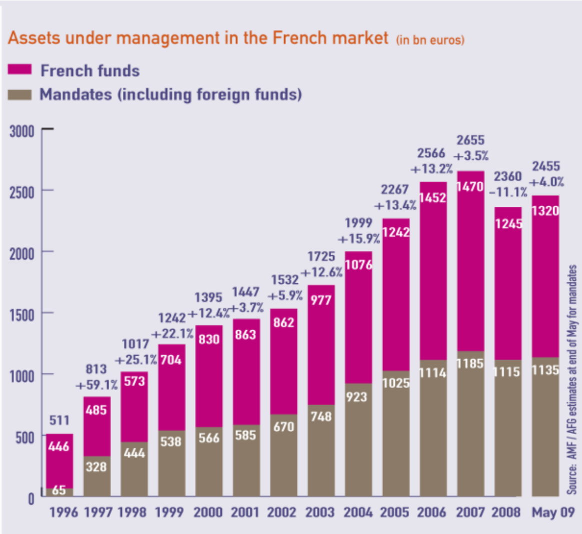
- long tradition in the fields *of financial mathematics and asset management*
- remarkable *development of innovation* for several decades
- *regularly adapted regulation* balancing investor protection and financial innovation
- *strong level of savings, diversified and efficient distribution channels*

Model resilience to the current market turmoil

The French asset management industry's model presents an appropriate set of tools to resist the current turmoil:

- An appropriate risk management within management companies
- Avoidance of conflicts of interest, to the benefit of investor's protection
- Specific approvals by the French regulator (AMF) regarding managers' skills and organization of management companies, especially for the use of complex products





AFG: The trade association of a world leading asset management industry

The Association Française de la Gestion Financière (the French Asset Management Association – AFG) represents and promotes the interests of the French asset management industry, both for collective and discretionary portfolio managements. Our members are management companies, either entrepreneurial or subsidiaries of French or foreign banking, insurance or asset management groups.

The French asset management industry: Key figures

- More than **560** asset management companies
- **2** French asset management groups rank among the top **10** at worldwide level, and **4** among the top **20**
- An increasing number of **entrepreneurial specialised management companies** (quantitative, absolute return, structured, hedge, indexed, credit, private equity, real estate, wealth management...). Nearly **150** new management companies have been created in the last 5 years in France
- Near **12,000** funds (including **8,300 UCITS Funds** and **3,700** non-UCITS Funds)
- More than **€1,300 billion for investment funds** – including **€1,200** billion for UCITS funds
- More than **€1,100 billion in discretionary mandates**
- **€1,000 billion managed out of France by foreign subsidiaries of French management companies**

Germany

Whilst Germany may be a world leader in many areas, its over-stretched pension system is badly in need of a serious overhaul. It has become clear that high unemployment and unfavourable demographics make change to the existing pay-as-you-go system necessary.

The Situation for intermediaries is still not consistently regulated in Germany at the moment. Although precisely because of the broad European term of an independent financial intermediary it is important to differentiate the specifics given by the German situation.

On the one hand there are insurance intermediaries which are highly regulated as a result of the transformation of the IMD. This fact allows showing up-to-date numbers of insurance intermediaries (source: DIHK 22nd of December 2009):

Number of Insurance Intermediaries in Germany

tied agents (Gebundene Versicherungsvertreter)	176.747
multi-tied agents (Versicherungsvertreter mit Erlaubnis)	33.771
brokers (Versicherungsmakler)	41.972
product accessory agents (produktakzessorische Vertreter) *product accessory means that for instance a travel agent can offer a travel insurance*	2.710
product accessory brokers (produktakzessorische Makler)	151
fee-based insurance consultants (Versicherungsberater)	174
total number of insurance intermediaries	**255.525**

On the other hand for intermediaries for investment funds and closed end funds exist an insubstantial regulation situation which is absolutely not comparable with insurance intermediaries and referring to this no valid numbers are present by today.

The events happened in 2008 have delivered a political climate which calls also in Germany for an increase of consumer protection in all finance related areas. Federal Minister of Food, Agriculture and Consumer Protection Ms Ilse Aigner released a "Quality Offensive Consumer Finances" and made demands on clear, comparable information and a high standard of consultation. In addition the government activities accelerate presently after change is coming by the election of German parliament in 2009. Due to these facts it is not difficult to predict that regulations will be expected soon. Already for 2010 the government rapidly launched several requirements for banks which are by far fulfilled through insurance intermediaries already.

Italy

Public pension expenditure in Italy grew from about 5% of GDP to over 15% in the early 1990's, outpacing all other categories of primary government expenditure and making Italy one of the biggest spenders on pensions in Europe. This has led to a move away from the state system towards private pensions.

Intermediaries (around 40,000 active out of the 60,000 officially registered) are becoming more relevant in the distribution process. There is an increasing need for advice and of a serious pension fund strategy to fill the social security gap.

Netherlands

The national savings and pension's law of 1953 shifted part of the burden of pensions away from the state system onto voluntary privately financed schemes. Over 90% of the workforce now belongs to a private supplementary scheme and it is common for retiring employees to enjoy a pension of 70% of their final salary.

Dutch investors are perceived to be conservative as 29% of funds invested in shares in comparison to 77% in the UK.

The Netherlands boasts a well-structured and large IFA sector. Requirements for foreign products (excluding institutional fund management) are limited, however, given the quality and diversity of local product suppliers.

Spain

Spain is increasingly moving away from the state pension system.

A politically strong association serves the intermediary market of (approximately) 20,000 largely under-trained and unsophisticated.

Switzerland

A strong fund management culture exists throughout the Swiss intermediary market and three associations promote the interest of their (total) membership of around 2,500 firms representing approximately a work force of 10,000 individuals.

They manage 10% of the total assets managed in Switzerland i.e. approximately CHF 400bn.

United Kingdom

With its well-developed pension system and high level of regulation the UK market is probably the most advanced in Europe.

The market for inheritance tax (IHT) planning products in the UK is growing fast. IHT is currently charged at 40% on estates in excess of £263,000 including the value of property. The amount of inheritance tax collected by the Inland Revenue has almost doubled over the last 10 years, to over £2.5bn in 2003-4 from over £1.3bn in 1993-4.

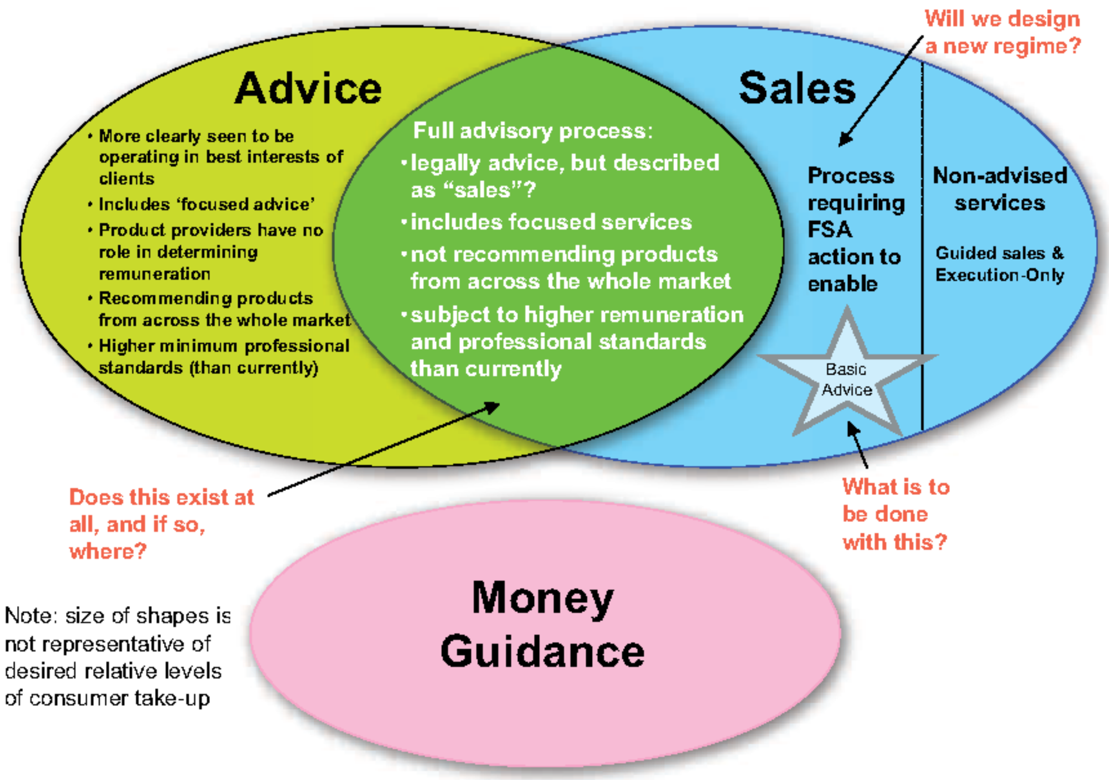
The Consumers Association suggested that the number of people affected by IHT has risen by 55% over the past 5 years.

Recent research suggests that in less than 10 years' time, one in eight Britons will retire abroad, and by 2020, this figure will be one out of five.

At the same time there is a growing trend for people to work abroad. At present, just 250,000 Britons leave the UK to work, but this figure is set to treble by 2012 and top two million by 2020.

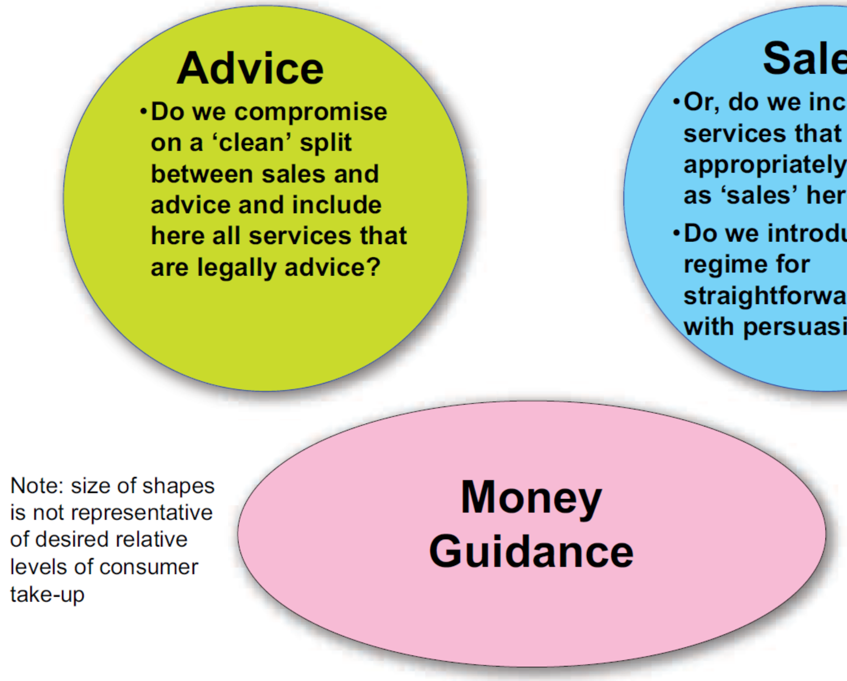
Insurance companies will be targeting employers who wish to "top-up" the pension arrangements of key employees, but are unable due to restrictions such as the salary cap.

The future of retail distribution: How do we tackle the consequences?



Source: FSA Retail Distribution Review – Interim Report (April 2008)

The Future of retail distribution: can we deliver a simpler landscape?



Source: FSA Retail Distribution Review – Interim Report (April 2008)

The professional advice community is a strong and growing sector. Latest results from a market study by Deloitte[2] show:

- There are over 16.000 adviser firms in the UK, employing 128.000 people
- Intermediaries accounted for 62% of regular premium sales and 66% of single premium sales in the life industry in 2005
- Total new business advised on by the professional advice community rose by 16% in the years from 2000 – 20005.
- Around 70% of firms employ 1-2 people but have a turnover of £382.000 per annum.
- Overall, the intermediary sector’s turnover was £6.5bn in 2005.
- The overall operating profit for the professional intermediary community is 13% of turnover
- Latest FSA research showed that the average adviser is now 48 years old
- Every professional financial adviser is required to hold entry-level qualifications equivalent to 3 “A” levels – though over 1.000 people now hold Chartered status which is post-degree level.
- Around 45% of the UK adult population have consulted a professional financial adviser

- 16% of the population regularly use a professional financial adviser

Deloitte research findings[1] illustrate the impact of advice:

- 60% increase in net assets by age 60 achieved through better management of debt, improved budgeting, better selection of financial products

- Four-fold increase in pension fund at retirement

- Increase in private pension of £2.100 per annum and an average decrease in pension credit by £600 per annum.

- An average increase in consumption of £50.000 over lifetime

- A two thirds reduction in the proportion of people facing financial stress (defined as periods where all financial assets are drawn down)

- A saving of £50m - £100m within ten years in saving made to pension credit

- The delivery of advice has the potential to improve wealth of target groups from £39bn to £78bn if only 10% were to optimise fully the advice given

[1] Research by Deloitte for the Resolution Foundation “Understanding the Impact of Financial Advice” September 2006
[2] Research by Deloitte for the ABI “Understanding Intermediaries”

RESTORING TRUST IN FINANCIAL SERVICES

(Source: AIFA (Association of Independent Financial Advisers) "Restoring trust in financial services")

Lack of Consumer Trust

There currently exists a general consumer trend towards cynicism and distrust which appears to have become more prominent in recent times. This trend has been confirmed by research from the Financial Services Consumer Panel (FSCP), which claims "consumer trust in traditional institutions is in decline, as consumers lose their traditional deference to authority" [iii].

On top of this, the Consumer Panel found there was a further trend towards cynicism and distrust "specifically within financial services". The Panel says the perceived profit, rather than customer, focus of financial services providers is driving an increasing distrust of them. This has been further exacerbated by recent experiences and media exposés such as credit card and overdraft charges and also the coverage of problems with UK banks. Also, it seems that people are increasingly information savvy; they are able and likely to question information, its source, motive and uses. The role of the internet, as a ready information source, and debating forum, is key to a thorough understanding of the changing position. As such, these trends together bring about an increasing distrust of financial services.

Many of these conclusions are supported by the findings of the Financial Services 'Trust Index', developed at the University of Nottingham on behalf of the Financial Services Research Forum to monitor levels of consumer trust in the industry [i]. The University has been producing the Index since 2005, and takes a forensically detailed approach to the research which aims to understand the influences on trust and benchmark the sectors within the industry.

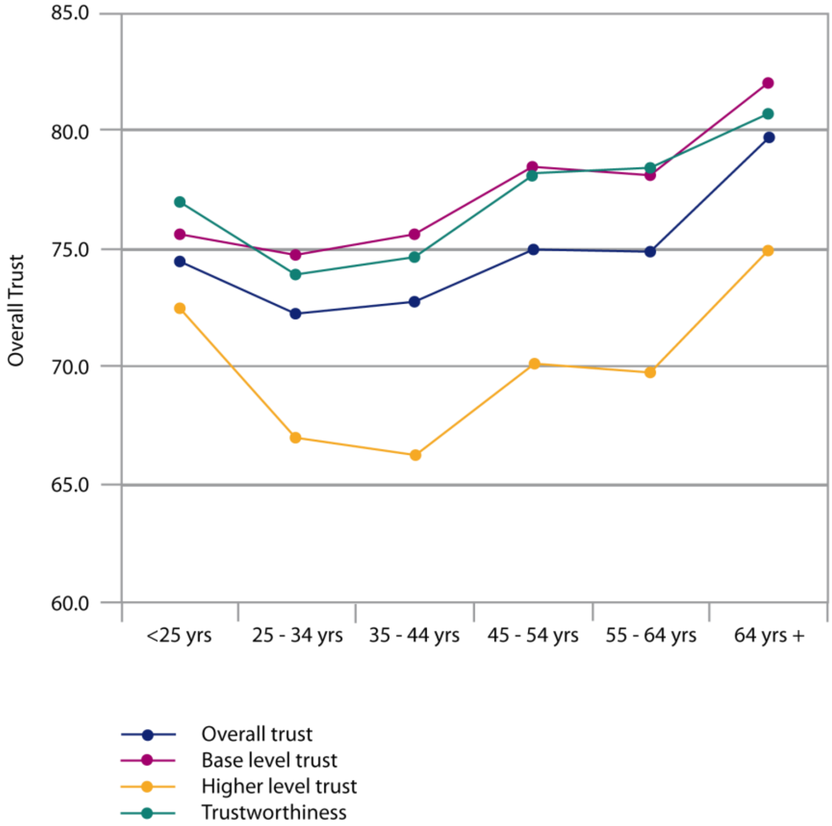
While previous surveys of the financial services sector have often been limited to simple yes/no answers, the Trust Index broadens this out by looking at how customers rated FSIs on two levels – low level trust (cognitive) and high level (affective) trust. Low level trust relates to the extent to which an organisation can be relied on to do what it says it will do and higher level trust relates to the extent to which the organisation is concerned about the interests of its customers.

The findings of the Trust Index indicate, for example, that many FSIs get their highest customer ratings in relation to reliability and competence in their field - i.e. in the area of 'low level' trust. But they find it much harder to present themselves to customers in terms of 'higher level' trust, particularly in relation to shared values. In other words, while many customers might trust their insurance company to operate efficiently in its sector, fewer feel that it has their interests at heart.

Trust by Age Group

The analysis by age also suggests that the issue of consumer trust could be a serious cause for concern in the longer term. Those aged between 25-35 show significantly lower degrees of trust in FSIs, perhaps reflecting different experiences of the financial services sector. This is suggestive of a significant challenge for FSIs in the future management of their relationships with customers in this age group.

Figure 1



(Source: The Financial Services Trust Index 2009, University of Nottingham)

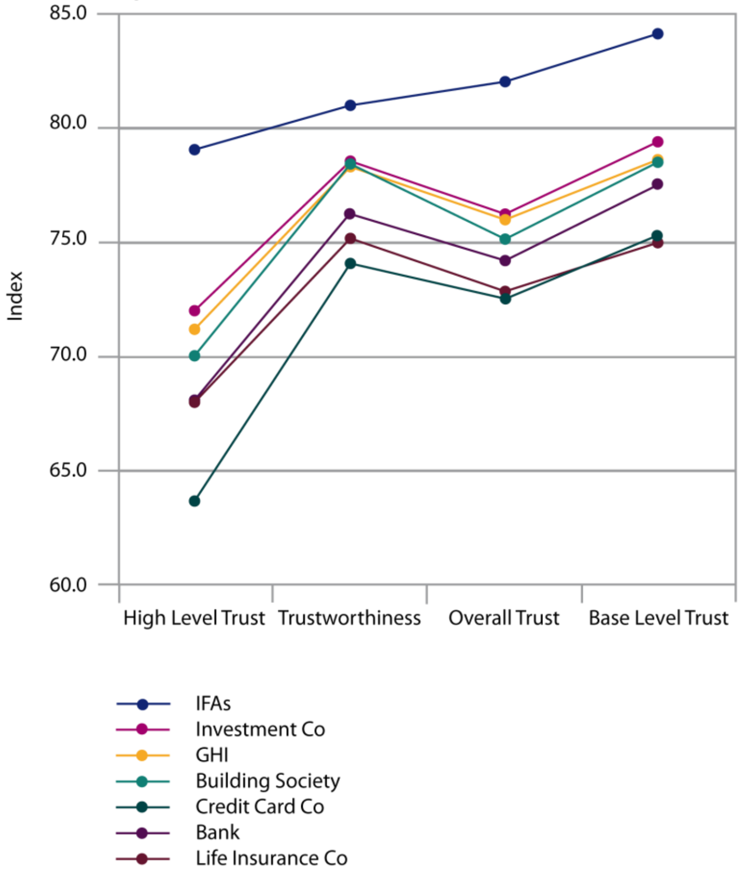
Trust by Channel

Another challenge for FSIs is the channel of interaction with consumers. Data from the Financial Services 'Trust Index' shows evidence of a decline in trust among users of internet channels and also shows that face-to-face relationships evoke greater trust than remote distribution. This face-to-face contact, and the more individualised nature of the service, underpins the relationship typified by the IFA. It also suggests that other financial services organisations may need to pay particular attention to the extent to which service delivery is depersonalised.

Trust and Trustworthiness by Institution

The 2009 Financial Services 'Trust Index' shows that IFAs are the most trusted FSIs in terms of base level trust, high level trust, trustworthiness as well as overall trust. IFAs are followed by investment companies, GHIs and building societies.

Figure 2

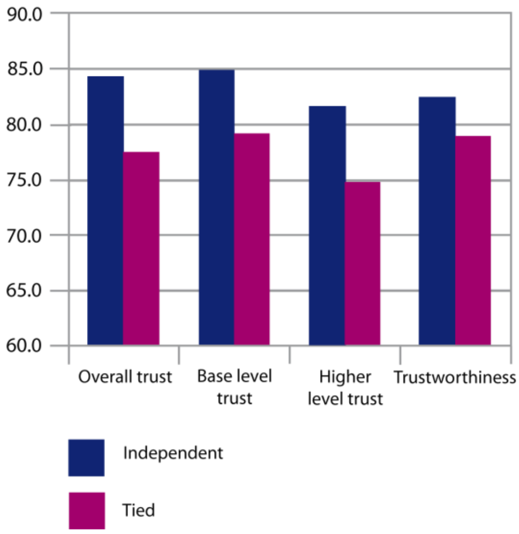


(Source: The Financial Services Trust Index 2009, University of Nottingham)

Trust by Broker Status

Comparative analysis with the previous Trust Index Surveys shows IFAs have consistently been the most trusted FSIs since the Index was established. The ratings for advisers who are independent are higher than those for advisers who are tied.

Figure 3

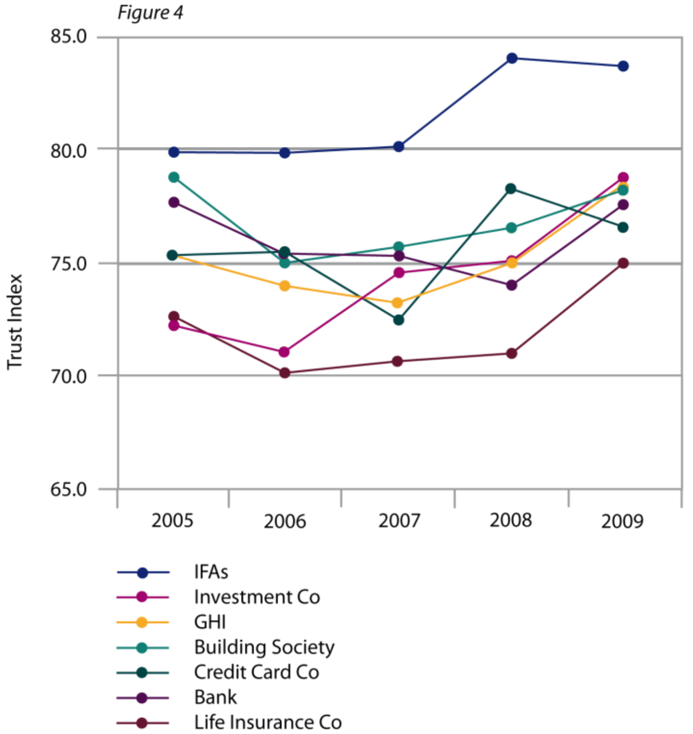


(Source: The Financial Services Trust Index 2009, University of Nottingham)

Base Level Over Time

Low level or 'base' level trust relates to the reliability and dependability of an organisation i.e. the extent to which it will do what it says it will do.

Figure 4

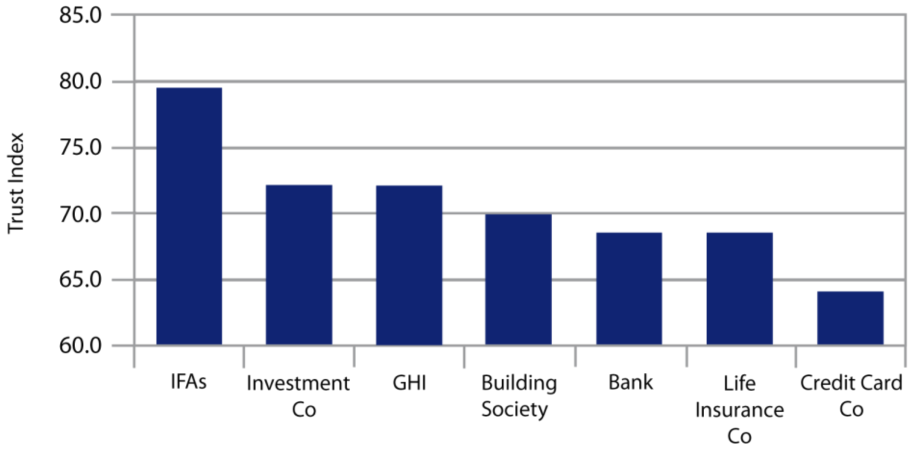


(Source: The Financial Services Trust Index 2009, University of Nottingham)

High Level Trust (2009)

High level trust for IFAs has also remained high over the past 18 months, no mean feat when the financial services industry is facing some of the worst economic conditions seen and is hardly out of the media's glare.

Figure 5



(Source: The Financial Services Trust Index 2009, University of Nottingham)

Therefore not only are Independent Financial Advisers (IFAs) consistently the most trusted of all FSIs, they also have consumers' high level trust as they are understood to operate on "shared values", picking up a phrase from AIFA's Manifesto for Advice [iv]. The public is growing to understand the IFA profession's core value: "The guiding light is to do well by the client".

Results from a July 2008, YouGov consumer survey confirmed these findings [v]. 86% of adults surveyed who had dealings with IFAs in the past 3 years, rated their services good or extremely good. 98% of consumers who already have an IFA state that it is their IFA who they trust most to offer financial advice. The YouGov research also showed that of the respondents who have had dealings with different FSIs in the past 3 years, 78% of those questioned trusted IFAs to treat them fairly; this is higher than the levels of trust consumers had in their dealings with banks, life insurance companies, pension providers and investment companies over the past 3 years. Eighty percent of those questioned were also confident that an IFA considered their personal needs above all else.

Tellingly, high level trust remains lower for all other FSIs. It is safe to assume that the impact of the difficulties faced by the sector in the wake of the banking crisis has lessened the extent to which consumers believe that financial services providers have their best interests at heart. Banks experienced a substantial decline in high level trust at the peak of the economic crisis, although thanks to the extensive Government backing announced last year, consumers have now regained some degree of confidence in them, although they still remain one of the least trusted FSI.

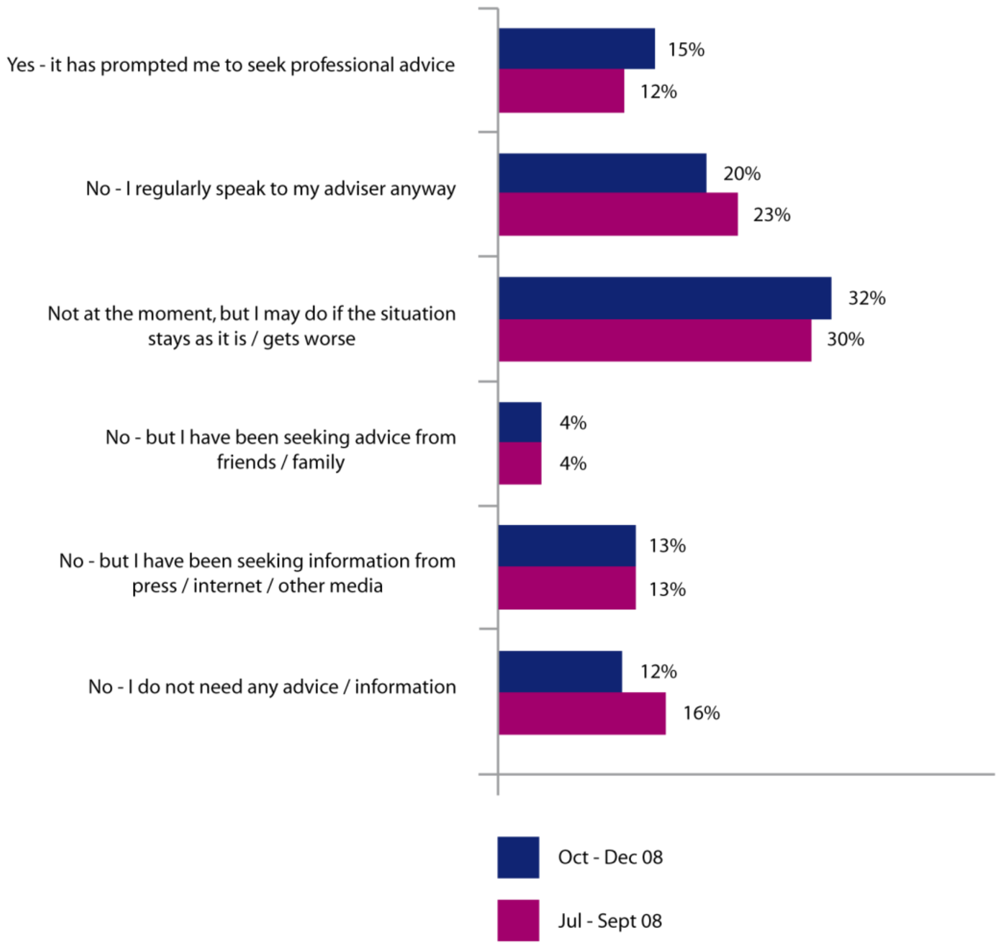
These findings are backed up by recent research from Which? that shows over a third of people (37%) think banks can not be trusted to act in the best interests of the UK economy, while 29% do not trust their bank to be sympathetic to them if they ran into difficulties [vi]. Additionally many people think that banks have been irresponsible with their lending too – 88% of people surveyed by Which? agreed that banks have encouraged excessive borrowing and 87% felt that banks should make better checks that people can afford to repay loans before they agree them.

While the turbulent market conditions may have damaged faith in banks and other FSIs, they have resulted in increased demand for the services of IFAs. 85% of IFAs surveyed by charity Turn2us in February 2009 reported an increase in the number of people coming to see them in financial difficulty in the last 6 months [vii]. The vast majority (95%) also expected to see a further rise in the 6 months to come.

Similar findings from research company NMG Consulting show investor attitudes are changing, and that a statistically significant number of consumers have been prompted to turn to IFAs for advice by the current economic conditions, and even more will be tempted to do so if the situation stays as it is, or gets worse [viii].

Impact of Current Conditions on Seeking Advice

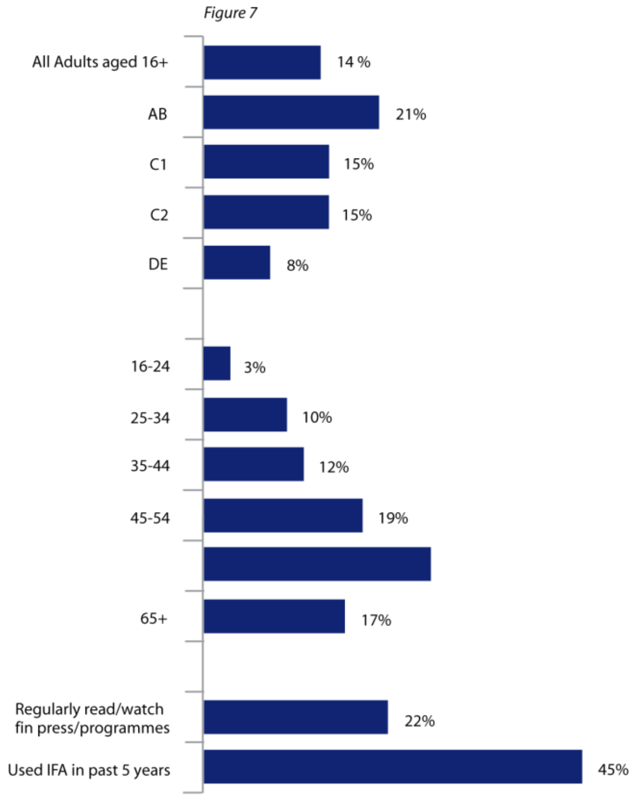
Figure 6



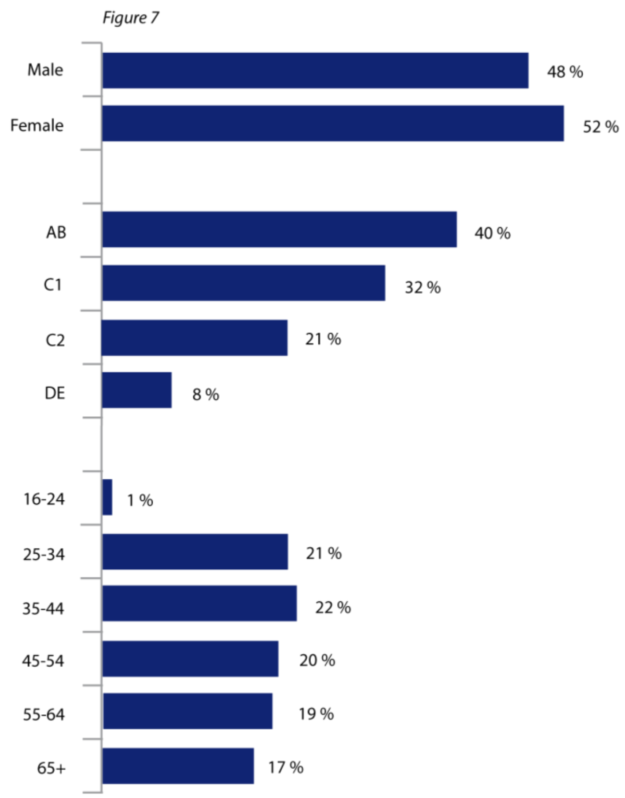
(Source: NMG Consulting, Investor Census July – Dec 2008)

It is also important to note that independent financial advice is not just a luxury for the rich. While the AB socio-economic group is more likely to use IFAs, a significant percentage of the groups C1 and C2 would also go to an IFA first if they wanted to get financial advice tomorrow (ix).

First stop for finding financial advice % saying "IFA on the high street"



Profile for those who have taken advice from any IFA in the last 5 years



In Summary

Several research sources confirm IFAs are consistently the most trusted of all FSIs, both in terms of people trusting them to operate efficiently in their sector, as well as trusting them to have their best interests at heart. This trust in IFAs has increased over the past 5 years, despite the economic turmoil and challenges of recent times. However, the same cannot be said for other FSIs who have seen their levels of trust not only remain low, but in some cases decline even further.

An increasing number of people from across the socio-economic groups are now turning to IFAs for advice to guide them through these difficult times, and these numbers are set to increase should the conditions continue or get worse.

Restoring Consumer Trust

A major problem is that the public are often confused about the role of FSIs as they are unsure of whether they are getting impartial advice or being sold a product. Research from IFA Promotions reveals 84% of UK adults admit they do not understand the roles and qualifications of the FSIs who claimed to be offering some form of 'advice'[x]. Indeed the ambiguity of financial services jargon misleads consumers and so perpetuates a feeling of mistrust in the sector. This is why AIFA believes there needs to be a clear separation of independent advice from all other types of services offered by other FSIs. The focus of regulatory policy should assist the public in recognising which firms are independent and which are offering a different service. As the weight of evidence now shows, people want to know who to trust – and they trust the IFA profession over all other options. It would seem if regulatory policy was to help the public have the confidence to re-engage with their own long-term financial well being, it should build on that which works.

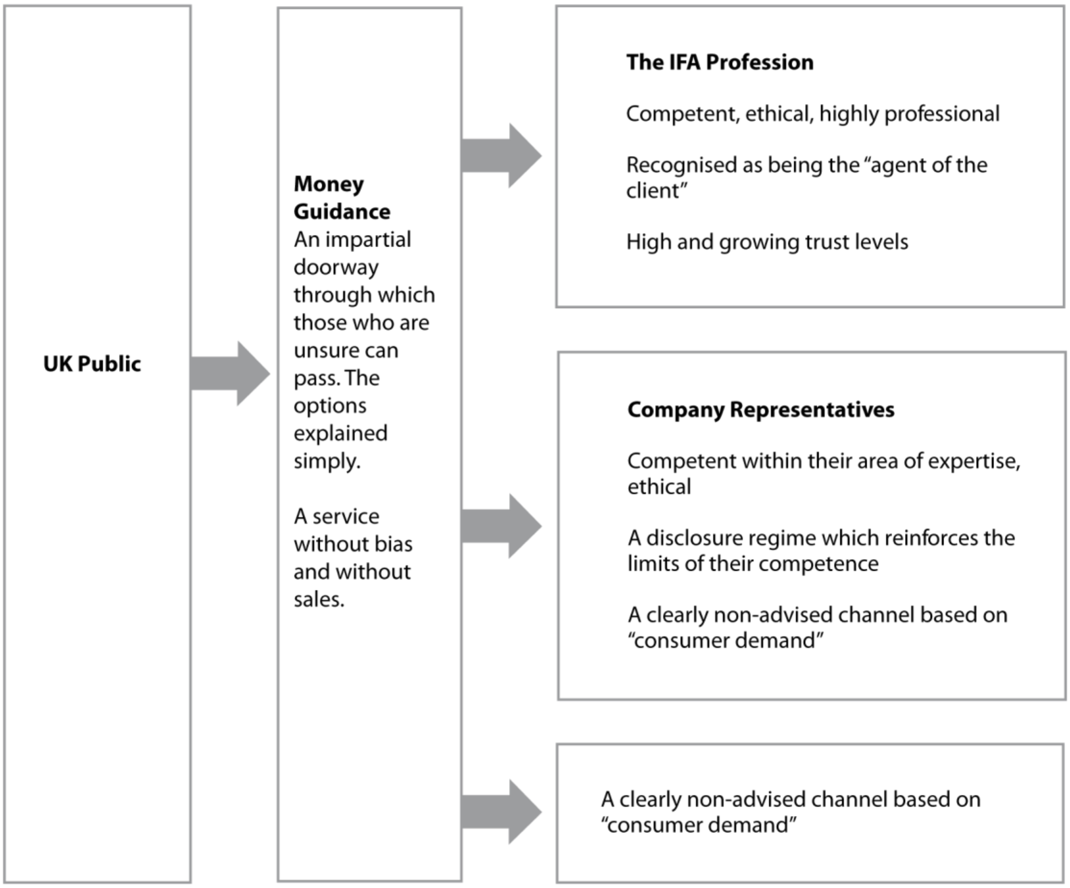
AIFA proposes:

- A market which has the fewest possible divisions, is easy for the public to recognise and navigate.
- Provides new 'doorways' through which people can pass to find the most appropriate solution for them.
- Talks to the public in everyday language and uses common sense terms with 'Plain English' standards.
- Allows consumers to better judge value by helping them to recognise the services available to them – their scope, limitations and costs.
- Helps those who choose to access financial services recognise the rights they enjoy and the responsibilities they have. As well as ensuring those who decide not to access the market understand the results of that decision.
- A regulatory structure that values competition and diversity, promotes confidence in the system, provides incentives for firms who excel, and is focused on raising standards in a way that supports the development of the market.

AIFA believes that in this way, trust and confidence in retail financial services will be returned. As a valuable by-product, the regulator's current aspirations set out in the Retail Distribution Review will be delivered.

AIFA's proposed "market map"

Figure 9



These proposals are for a market which is simple for people to recognise and easy to navigate.

There should be total clarity of the available options - it should be easy for the public to tell who is offering them independent financial advice and who is selling them a product. It should build on consumer understanding of simple words like "advice" and encourage competition and higher standards.

This improvement is essential, for, as FSCP stated in its report, "the current advice landscape is characterised by confusion and negative emotions" [iii]. The report added that a clear distinction between those in the "sales" arena (labeled in fig [vi] as Company Representatives) and independent advice should "reduce distrust and confusion in the advice market and in theory may enhance the propensity of consumers to seek advice."

Disclosure

All forms of disclosure to consumers, both written and oral, should be based on everyday language which moves away from industry jargon and allows consumers to easily understand what they are being told. It is crucial that the labels used to describe the FSI make absolutely clear to consumers the distinction between the various business models and what they can deliver.

Regulatory proposals to allow tied and multi-tied company representatives to call themselves 'sales advisers' (as currently set out in the RDR Feedback Statement, but which we label as 'Company Representatives' a clearer term in everyday usage) create a muddy middle ground which will only continue to confuse customers and damage trust. AIFA agrees fully with the FSCP which shares the belief that the term "sales advice" is "devoid of meaning" [xi].

AIFA also strongly agrees with Which? when it says, *"There has to be a clear distinction between those offering unbiased advice and those simply trying to sell products. It must be made crystal clear to consumers what type of service they are receiving and how they are paying for it"* [xii].

Consumers clearly value the concept of independent and unbiased advice. IFA Promotions found 95% of people believe it is important that the adviser can recommend the most suitable products from the whole of the market; and 88% say it is important that an adviser has no commercial ties to product providers [x]. YouGov consumer research commissioned by AIFA in 2007 produced similarly high statistics - 75% of those who receive advice from an IFA expect them to be someone that can select a product from the whole of market to best suit their needs while 73% of those questioned expect IFAs to work for their interest and not for anyone else's [xiii].

Further research conducted by YouGov on behalf of AIFA in July 2008 showed 81% of the 2,453 adults questioned thought that knowing whether they were being sold a product or given personal advice would build trust in FSIs, while 77% of people thought knowing an FSI was 'on their side' would build trust [v].

The research also indicated that when considering the most important features of an FSI, consumers believed that dealing with a firm that is on their side, or agent of the client, is a key consideration. This therefore makes clarity of the FSI's role the most important feature when consumers are considering who can help them and who they can trust. We believe this further underlines the importance of the differentiator that advisers work on behalf of, and as agents of, their clients.

It is also important that the disclosure regime insists that the limits of the firm's scope, and individual's competence, are set out clearly so that the client may better judge the value of the service offered.

Financial promotions

Changes to the current disclosure regime are necessary – but not sufficient to bring significant improvement. The financial promotions regime must also be reviewed. Disclosure occurs once a potential customer has engaged with a firm, by that stage they may feel under pressure to continue with the process.

AIFA proposes that a new financial promotions regime is introduced which helps the public understand what the firm can offer them, even before they enter into a conversation. This would include not only above the line advertising but also the signage on any retail premises – and most certainly the firm's websites and all promotions.

Sources:

i. Financial Services Research Forum, University of Nottingham: The Financial Services Trust Index 2008 - June 2008
iii. Financial Services Consumer Panel: Exploration of Consumer Attitudes and Behaviour With Regard to Financial Advice and the Implications of RDR Proposals - January 2008
iv. AIFA: A Manifesto for Advice – January 2008
v. YouGov Consumer Research on behalf of AIFA: Financial Service Institutions – July 2008
vi. Which? Press Release 'Banks fritter away their trust' – 17 February 2009
vii. Turn2us Press Release 'Advisers struggle to meet demand as more seek financial help' – 25.02.2009
viii. NMG Consulting, Investor Census July – Dec 2008
ix. AIFA: Financial Advice, Worth the Money? – January 2008
x. IFAP Annual Survey – January 2006
xi. Lord David Lipsey Speech, FSA RDR Conference – 25 November 2008
xii. Which? Press Release: 'Putting the 'Independent' Back Into IFA' – 25 November 2008
xiii. YouGov Consumer Research on behalf of AIFA – June 2007

8.3 FUNCTIONAL DESCRIPTION

8.3.1 Economic description

Investment funds are a form of collective investment vehicle that invests (purchases assets, such as stocks, bonds and money market, etc.) the pooled funds of a large number of investors for a fee. Funds raise money by selling shares of the fund to the public/investors (like any other company which can sell stock to the public). In return, shareholders receive an equity position in the fund.

Unit-linked life insurance products, apart from offering biometrical risk coverage, can serve as savings products offered by insurance companies. The investment is made under a contract between the insurer and the investor, under which the insurer invests the money on the investor's behalf. The assets are owned by the insurance company, which promises to provide a return to the customer based on the investment performance of the underlying assets. In exchange for the amount invested, the investor is provided with a contractual right to a share in the income, profits or losses from a defined asset pool. The insurer may manage (internally) the assets on which the units are based, or use the money provided by the investor to buy units in a fund, or funds managed by third parties.

Structured products/notes are securities derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance and/or a foreign currency. In simpler terms, a structured product is essentially a contract between the investor and the issuer, usually an investment bank which promises to make at a certain time a payout based on a formula explained in the prospectus.

8.3.2 Customer segment

Each of these financial industry sectors comprises a well developed retail segment in the EU.

Investment funds may be UCITS or nationally regulated funds. UCITS are designed for retail investors although around 25% of assets under management (AuMs) are distributed to institutional investors. They are increasingly distributed on a pan-European basis through the UCITS "passport". Nationally regulated funds may be authorised, provided certain national rules are met, for distribution to retail investors.
According to the life insurance industry, the vast majority of, if not all, **unit-linked life insurance products** are contracts with mass and affluent market policyholders, including high-net worth individuals (HNWIs).
Although **structured notes** may be specifically designed to meet institutional investors' needs, market research suggests that in the EU the vast majority of structured notes issues are held by private individuals.

8.3.3 Economic objectives

Investment funds, notably UCITS intend: 1) to yield a superior return than a traditional bank deposit by investing in specific investments (in line with the objectives of the investors and the regulatory constraints); 2) to give investors access to a wider range of securities than the investors themselves would have

been able to access (diversification); 3) to assure redemption on demand (liquidity) and 4) to reduce trading costs by gaining economies of scale in operations.
The purposes for which **unit-linked life insurance products** are purchased vary widely from retirement savings to tax-advantageous short-term investments. Depending on the investment objective, the importance of the insurance element can also vary. They are predominantly used for regular premium pension saving. Non-pension medium-term savings are mainly lump sums.

Structured products intend: 1) to yield superior returns than traditional bank deposits; 2) to give investors access to complex investment strategies and a wider range of securities and asset classes that would not usually be available through traditional investment funds, for example, a specific basket of equities, commodities, foreign-exchange and hedge funds; 3) to assure a certain level of liquidity (although redemption is discouraged by penalty exit-fees in some cases); and 4) to lower trading costs via economies of scale. Combinations of derivatives and financial instruments create structures that have significant risk/return and/or cost savings profiles that may not be otherwise achievable in the marketplace. Structured products are designed to provide investors with highly targeted investments tied to their specific risk profiles, return requirements and market expectations. Some structured products offer full protection of the principal invested, whereas others offer limited or no protection of the principal. In other cases, losses can be magnified by leverage.

8.3.4 Investment features and restrictions

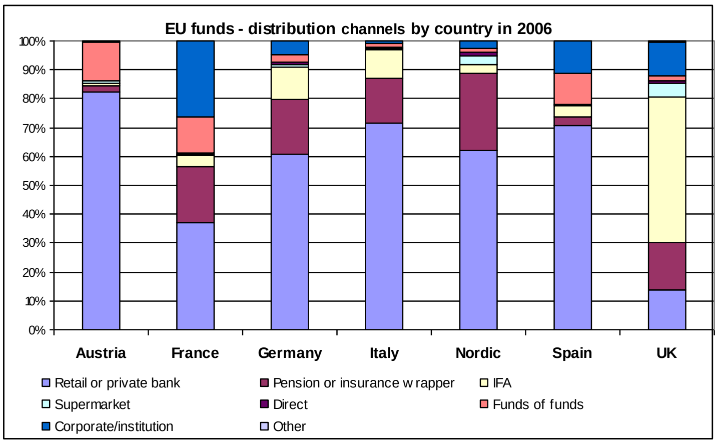
To protect retail investors, in addition to rules relating to fund diversification, liquidity and use of leverage, the **UCITS Directive** imposes strict rules on the investment policy of funds. The discretion of the fund manager is legally restricted so that investors do not have to rely on the skills and the due diligence of the fund manager alone. Under these rules, only transferable securities (mainly equity and bonds) were eligible assets. Directive 2001/108/EC has expanded this list to include also money market instruments, units of UCITS and other collective investment undertakings as well as banking deposits and allows greater use of derivatives, although under strict conditions. Non-UCITS which are authorised for retail distribution at Member State level have to comply with similar rules, albeit some variations notably in terms of eligible assets or diversification limits.

Unit-linked life insurance products can invest in UCITS as well as in non-UCITS like real estate funds. They also allow funds within a fund. There are no limits on liquidity.

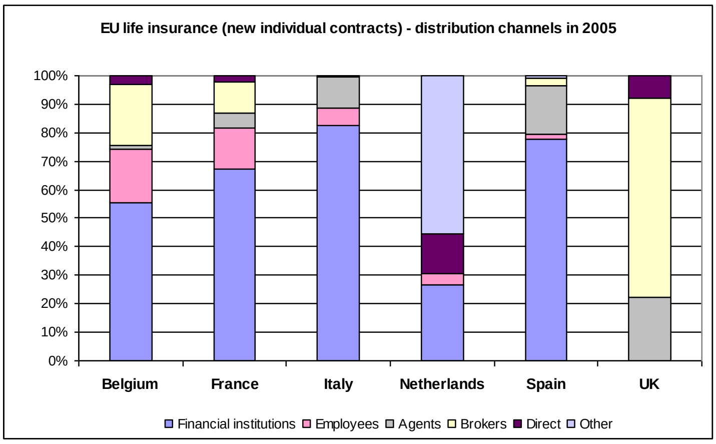
Structured products are more complex in terms of investment strategies. They are generally not bound by any restrictions specifying the permissible level of market risk. As a result, the range of assets has expanded considerably over recent years (equities, investible indices – including commodity, hedge fund or forex indices – or even house price movements). The underlying assets are not the single parameter to take into account to assess structured product features. The others are: exercise ratio (the fraction of the underlying invested in derivatives), maturity (the point in time when the structured product is redeemed) and the pay-out terms.

8.4 DISTRIBUTION CHANNELS

Sales of investment funds, unit-linked life insurance products and retail tranches of structured products take place through similar distribution channels.
In the EU, commercial banks and insurance companies remain the largest distributors but their market share in fund distribution fell from 97% to 75% between 1990 and 2005. In the UK, independent financial advisors (IFAs) are the main distribution channel. The distribution of funds is evolving towards open architecture (i.e. opening up the existing distribution channels to third-party funds) or ‘guided’ architecture (where distributors select a limited number of additional providers to increase and/or change the range of products they sell through their distribution network). The market share of these business models is reported to have increased from 2% to 11% between 1990 and 2005. Moreover, new distribution channels emerge, such as IFAs – the share of IFAs increased from 1% to 7% between 1990 and 2005 - as well as Internet-based distribution channels. However, this process is slow and varies significantly by jurisdiction.

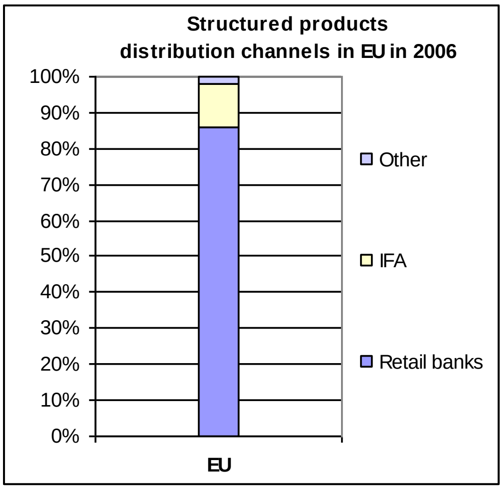


No readily available data has been found on distribution channels for unit-linked life insurance products. Thus, this graph encompasses all life insurance products (not only unit-linked ones) in the concerned countries. They are premiums to new individual contracts. Financial institutions (i.e. banks) remain the main distribution channels, except in the UK where brokers predominate. Life insurance distribution is also taking place through employees (of the insurance company) and agents, which all are insurance networks. Anecdotal evidence suggests that unit-linked life products tend to be sold through an advised sale. Distribution methods vary considerably across the EU.



Banks are the primary distributors of structured products in the retail market, with a market share close to 86%. The main reason for this is that small retail investors - the bulk of the market in most countries - prefer to buy these products through banks. Some banks choose only to market their own products, while others sell structured products manufactured in-house plus those structured by other organizations (known as open-architecture framework). IFAs and brokers accounted for 12% of structured product retail sales in 2005. They are individuals or organizations employed to provide investment advice on a fee basis, with brokers acting as intermediary between the product issuers and buyers of structured products. They can either sell structured products from multiple issuers or from one single issuer. There are also other distributors, such as insurance companies in Germany and Belgium, post offices and even supermarkets in the UK, and online platforms in Italy and Switzerland.
Data on distribution channels are not readily available as regards structured products. However, industry estimates distinguish between three types of clientele:

- retail customers: commercial banks are the key distribution channel for this segment (estimate: 85%). IFAs are the second channel,
- HNWI: Private Banks and IFAs are a particularly important means of distribution across Europe, except in Germany and Italy,
- institutional investors: direct distribution (from the structurer) is the most popular option for institutional investors.



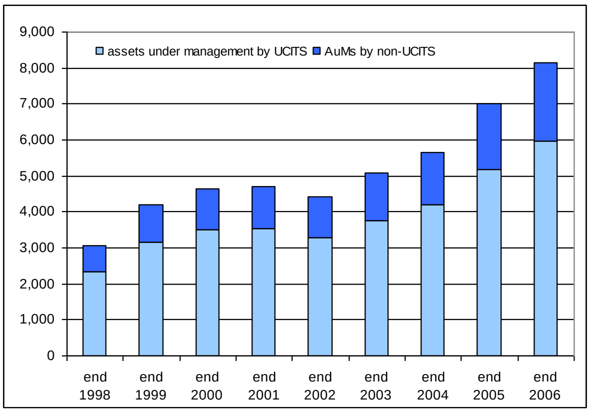
Cross-product interaction: Due to the lack of readily available data on the composition of structured products portfolios, it is not possible to know to what extent they may encompass investment funds. However, anecdotal evidence suggests that they are emerging as a distribution channel for investment funds. Finally, anecdotal evidence suggests also that life insurance wrappers are increasingly used to wrap retail structured products. With the exception of Austria and Spain, insurance or pension wrappers are emerging as the second way of distribution of investment funds.

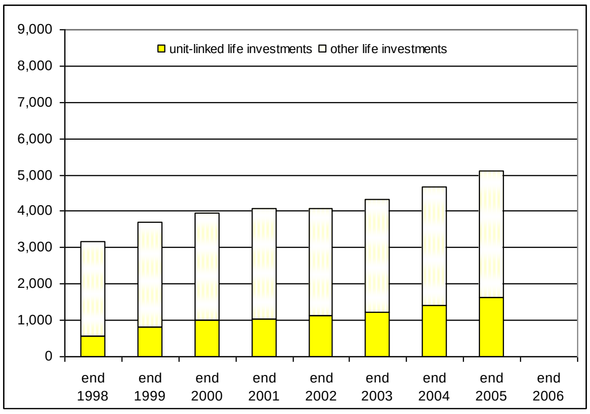
8.4.1 Market size

Sources of data and figures *in the two sections below: Association of British Insurers (ABI); Bank of England (Financial stability review); European insurance and reinsurance federation (CEA); Deutsche Bank research; FERI Fund Market Information; European Fund and Asset Management Association (EFAMA); International Swaps and Derivatives Association (ISDA); Netherlands authority for the Financial Markets (NL-AFM); PricewaterhouseCoopers; Société Générale Corporate & Investment Banking (SGCIB); Structured Products Association; Swiss Re sigma research; www.structuredretailproducts.com; and EC estimates.*

8.4.2 Size of outstanding capital – comparison of scale

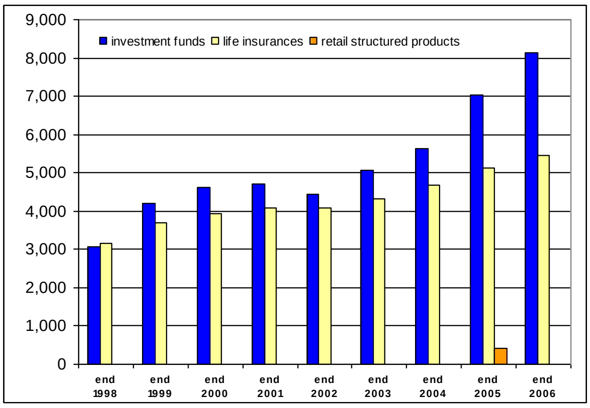
At end of Q1 2007, assets under management by UCITS amounted to € 6,213 billion; EU non-harmonised investment funds, € 1,666 billion plus c.a. € 350 billion by EU managed hedge funds and € 180 billion by private equity funds.





In € billion

The total investments of the life insurance industry were estimated at € 5,460.30 billion at end of 2006, up from € 5,127.00 billion in 2005 out of which 32% are related to unit-linked products.
At the end of 2005, the total outstanding capital invested in structured products by retail investors was estimated to be at least € 423 billion. No other data are readily available in terms of outstanding capital for other years.

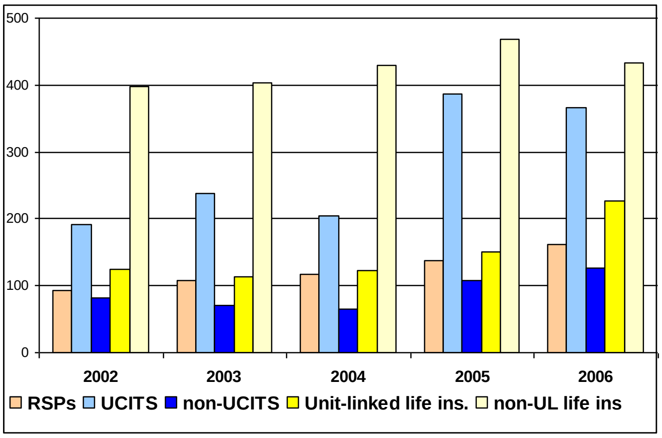


In € billion

Despite the lack of data on outstanding capital of retail structured products in the EU, a comparison of scale suggests that this market remains relatively small in comparison with the markets for UCITS and retail non-UCITS, and also for unit-linked life insurance products.

8.4.3 Net sales in EU and certain member states

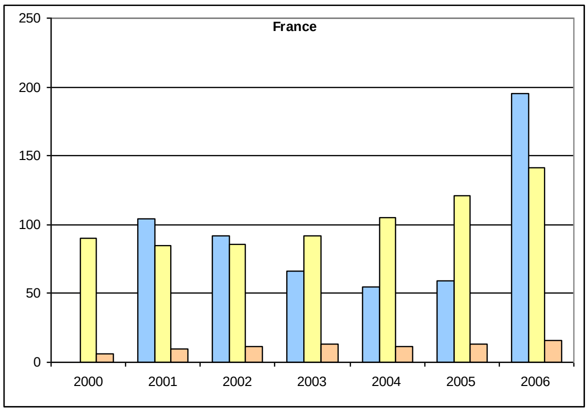
In terms of EU sales, however, retail structured products are performing very well, just behind unit-linked life insurance products but above non-UCITS. Non-unit-linked life insurance products and UCITS remain the best performers in terms of sales in EU.

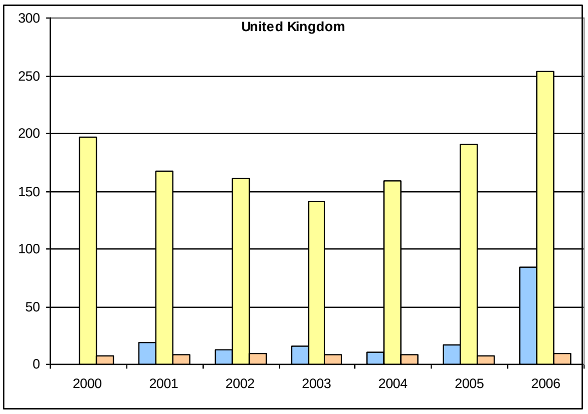


In € billion

Interestingly, four patterns are emerging at national market level. In the following diagrams, premia to life insurance products are in yellow; net sales (inflows less outflows) of funds in blue; and sales of retail tranches of structured products in orange.

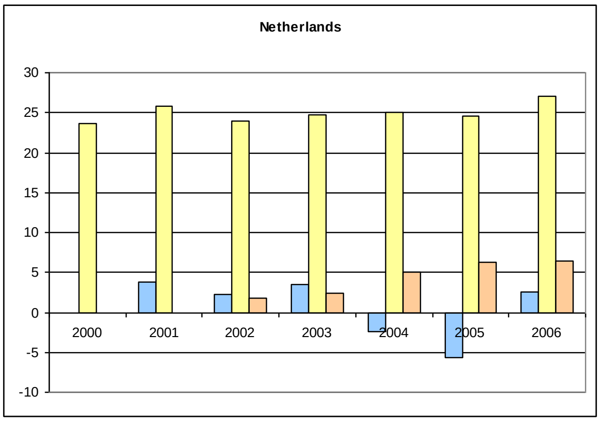
1. UK and France remain markets for funds and life insurance products. Structured products are less developed:





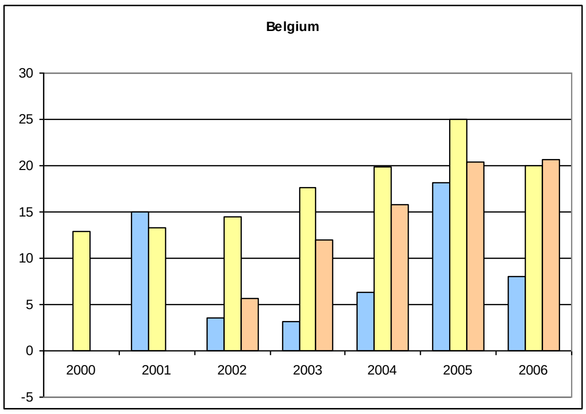
In € billion

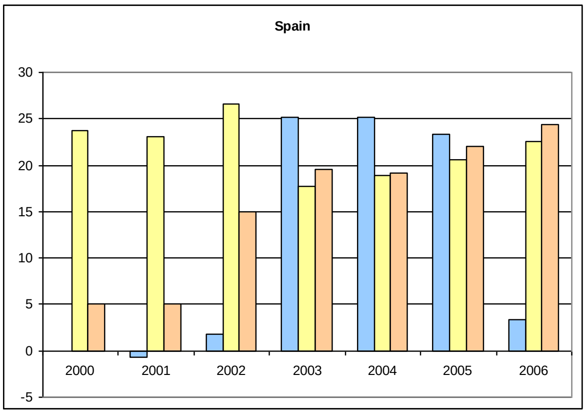
2. In the Netherlands, where fund sales are historically low, structured products are increasingly competing with life insurance products:



In € billion

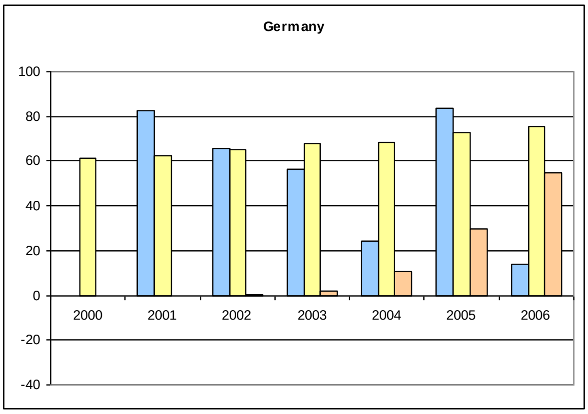
3. In Belgium and Spain, structured products are competing with other forms of savings;

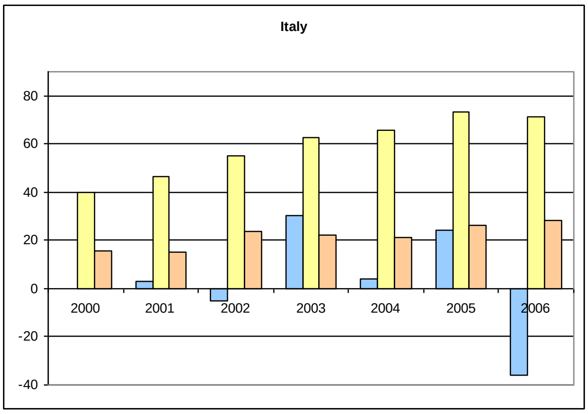




In € billion

4. In Germany and Italy, structured products are gaining market share over other products, notably funds:





In € billion

8.4.4 Cross-border sales

UCITS are increasingly sold on a cross-border basis in the EU, with Luxembourg and Ireland as leaders. This is widely explained by the UCITS Directive and the pan-EU passport that it provides to investment funds complying with its provisions.
Life insurance products are distributed on a cross-border basis much less frequently. However, market data suggests that in 2005, Luxembourg, Ireland and UK based life insurance products (not only unit-linked products) have received premia from Member States other than the jurisdiction of domicile (respectively, 90.61%; 36.48%; 9.63% of the total premia). Contract law and claims settlement as well as taxation systems represent a more significant barrier to the cross-border sale of unit-linked life insurance.
Although no data is readily available, it seems that cross-border sales of structured products are negligible in the EU. This appears at odds with the Prospectus Directive provisions allowing the pan-EU distribution of notes which comply with its requirements. It may be due to a cultural preference for nationally branded products. The cross-border sale of structured notes/funds could easily develop – the current low levels of cross-border sales reflect commercial or cultural factors and the geographical organisation of distribution systems: there are no major regulatory or legal impediments to their cross-border offer.

8.5 LEGAL AND REGULATORY TREATMENT UNDER EU LAW

In all Member States, **investment funds** or units in undertakings for collective

investments are addressed by national law, which distinguishes them from other financial products or assets.
They belong therefore to a *sui generis* category. At EU level, the UCITS Directive defines UCITS as undertakings the sole object of which is the collective investment in transferable securities and/or in other liquid financial assets referred to in Article 19(1) of capital raised from the public and which operates on the principle of risk-spreading and the units of which are, at the request of holders, re-purchased or redeemed, directly or indirectly, out of those undertakings' assets.

A **unit-linked life insurance** is a product offered by insurance companies. The investment is made under a contract between the insurer and the investor, under which the insurer owns the underlying assets on which any investment return is based. In exchange for the amount invested, the investor is provided with a contractual right to a share in the income, profits or losses from a defined asset pool. The insurer may manage the assets on which the units are based, or use the money provided by the investor to buy units in a given fund, or funds managed by third parties. There is no legal definition of unit-linked life insurance products within EU law. Annex III "Information for policy holders" of the Life Insurance Directive indirectly describes unit-linked policies (see items (a)11 and (a)12) by requiring specific information for policy holders of such products.

Structured products may adopt different legal forms according to the market they target, the distribution channels they use or the jurisdiction where they are domiciled. Most EU-based structured products adopt the legal form of a bond or a note, e.g. in Germany most structured products or certificates are bonds for legal and tax efficiency reasons. In France for instance, they may take the form of an investments fund, i.e. structured funds or "formula" funds where the assets in which the fund invests combine some secure investments with derivatives. But some French structured products are also bonds. Finally, in some countries, such as Belgium, structured products adopt the legal form of a life insurance contract.

8.6 RULES FOR PRODUCT CONSTITUTION

Under the **UCITS Directive**, UCITS must comply with investment restrictions (eligible assets, risk dispersion, diversification, etc.). They must be redeemable on investor demand. And, they must comply with rules to protect investors such as: initial approval of the management company, fund rules, choice of depositary, capital requirement, risk management process, etc. Each new UCITS has to be authorised by the competent authority, i.e. authorization is given product by product. Any change to the management company or the depositary must be approved by the home regulator.
Unit-linked life products are regulated by the **Life Insurance** and **Solvency 1** (to be amended as Solvency II) Directives and the Capital Requirements Directive (CRD). Thus, specific solvency and prudential rules apply to the originators of unit-linked life insurance products. The life company's capital has to fulfill the requirements of the CRD. Authorisation is given to the insurance company for a whole insurance class. Once a company has been authorized in the class of insurance devoted to unit-linked insurance, it is allowed to sell, without prior approval, new contracts that falls within one of the categories listed in the authorisation.
There is no EU piece of legislation which governs the constitution of structured

products with the legal form of a bond. Structured products with the legal form of investment funds or life insurance products are subject to the relevant EU rules governing the constitution of such products. Each prospectus has to be authorised by national authority. The Prospectus Directive allows incorporation of a prospectus by reference to previously published documents that have been approved.

8.6.1 Rules for disclosure to investors

UCITS are subject to disclosure requirements as set out in the **UCITS Directive** in the form of the **Simplified Prospectus** that must be provided before the conclusion of the contract and, on request, a full prospectus, an annual report and a half-yearly report covering the first six months of the financial year. In addition, **MiFID** imposes high-level disclosure requirements notably in relation to the distributor (when it is MiFID regulated).

The third Life Insurance Directive of 1992, consolidated by the 2002 Directive concerning (the **Consolidated Life Directive)** direct life insurance, indicates in a detailed list the information to be provided to the policyholder prior to the conclusion of the contract. The information will first relate to the insurance undertaking and to the commitment itself. Specifically regarding unit-linked policies, definition of the units to which the benefits are linked as well as indication of the nature of the underlying assets must be disclosed. The **Insurance Mediation Directive** (IMD) includes some disclosure requirements regarding the intermediary (status, service and suitability).

Structured products (with the legal form of bonds) which are intended to be distributed to the public on a pan-EU basis are subject to the **Prospectus Directive**. Prospectuses must describe the essential features and risks associated with the issuer and the securities issued. The information required includes considerable detail on the issuer, but may be less explicit about the financial details of the product. In addition, **MiFID** imposes high-level disclosure requirements notably in relation to the distributor (when it is MiFID regulated).

8.6.2 Rules for product distribution

Direct sales by the management company of its own products are governed by the relevant provisions of the **UCITS Directive**. **MiFID** applies to intermediaries which sell third-party investment funds. It provides rules on conduct of business, management of conflicts of interest and quality of order execution as well some disclosure (related to the distributor) provisions.

The **Insurance Mediation Directive** requires insurance intermediaries to deliver written advice, taking into account the demands and needs of the policyholder. The scope of this obligation might be considered to be similar to that applying to financial advisors. However, employees of insurance companies, who are not considered as intermediaries, are not within the scope of IMD and hence are not subject to the same obligation.

MiFID applies to distributors which offer either third-party or proprietary structured products with the legal form of a bond. MiFID provides rules on conduct of business, management of conflicts of interest and quality of order execution as well some disclosure (related to the distributor) provisions.

8.6.3 Other potentially applicable EU rules

In addition, other provisions of EU law may be applicable to the distribution of investment products.

According to the **E-Commerce Directive** service providers are entitled to provide their services by the means of Internet throughout the EU, exclusively on the basis of the rules of the Home Member State without any further restriction. Indeed, in contrast to the UCITS Directive, for instance, which confers some residual competences to the Host Member State, the e-commerce Directive is based on a strict “country-of-origin” principle. This Directive imposes certain information requirements for the conclusion of contracts by electronic means. In addition to other information requirements established by EU law, the service provider must give the following information prior to the service provision:

- ✓ the technical steps to follow to conclude the contract;
- ✓ whether or not the concluded contract will be filed by the service provider and whether it will be accessible;
- ✓ the technical means for identifying and correcting input errors prior to the placing of the order;
- ✓ the languages offered for the conclusion of the contract;
- ✓ any relevant codes of conduct to which he subscribes and information on how those codes can be consulted electronically;
- ✓ contract terms and general conditions provided to the recipient must be made available in a way that allows him to store and reproduce them.

Moreover, the service provider shall render information on its name; address; e-mail address; company registration number; professional title; VAT number; and details of membership of professional associations easily, directly and permanently accessible. These requirements are in addition to those imposed by MiFID.

The **Distance Marketing Directive** (DMD) applies to distance sales, inter alia, to the distribution of financial services or products sold by the means of distance communication, i.e. those means which do not require the simultaneous physical presence of the supplier and the consumers such as fax, telephone and again Internet. In contrast to the e-commerce Directive and similarly to the UCITS Directive the Distance Marketing Directive recognises certain residual competences of the Host Member State. The Distance Marketing Directive also regulates the information which has to be provided to the investor. The "distance marketing information" must be provided before the client is bound by a contract. This information includes:

- ✓ all the contractual terms and conditions and the information on paper or on another durable medium available and accessible to the consumer in good time before the consumer is bound by any distance contract or offer;
- ✓ the identification of the supplier;
- ✓ the description of the financial services;
- ✓ the characteristic of the distance contract; and
- ✓ the existence of a redress.

Although the DMD requirements appear to add a separate layer of information to be disclosed, these requirements are often already satisfied through existing disclosure requirements. They are partly similar to those of the UCITS Directive.
These two Directives may be seen as making the regulatory patchwork governing distribution of financial products to retail investors even more complex. The question of the relationship of their provisions with those of other Directives (such as MiFID, UCITS, IMD, Prospectus, etc.) may arise. The two directives do not establish exemptions to the application of the complementary provisions of the UCITS, MiFID, Life Insurance and Insurance Mediation Directives. The obligations to offer information and advice provided for by these latter directives should consequently be applicable for distance marketing.
Other concerns arise when investors purchase financial products directly from the issuer/promoter, via the Internet, for example, without the services – and, so, without, the advice - of an adviser or a distributor. In so doing, they make an investment decision on an "execution only" basis - they can then only rely on their own examination of the prospectus and the brochure - as the transaction takes place at the client's initiative.

8.6.4 Different national approaches at Member State level

Nationally regulated investment funds offered to retail investors are subject to similar rules to those applicable to UCITS in most, if not all, Member States. All Member States have put in place rules such as approval of the management company and its instruments of incorporation, the fund rules and the choice of a depositary; authorisation of funds by the competent authority; sufficient good repute and sufficient experience of the directors of the management company and the depositary. In order to protect investors, notably retail ones, Member States generally set out an exhaustive list of eligible assets although these may be different from the UCITS Directive list (e.g. real estate, commodities, etc.); fixed quantitative investment limits (issuer concentration limits, counterparty risk, limit to market risk); exclusions or restriction of certain investment techniques (e.g. no short sales, no borrowing); etc.

Unit-linked life insurance products: National regimes for the constitution of unit-linked life insurance products are based on or implemented from the EU legislative framework (Consolidated Life Insurance Directive). However, this minimal harmonisation framework does not result in large scale pan-European distribution of unit-linked life policies, due to differences in Member States' contract law, tax requirements and pension arrangements.
Constitution (or incorporation) of **structured products with the legal form** of bonds is regulated at national level. Depending on the Member State in which it is based, a structured note issuer will have to comply with the relevant provisions of company law or contract law.

8.6.5 Information to investors

The MiFID includes a number of harmonised rules and requirements related to provision of certain financial services, investment advice and disclosure of appropriate information. As mentioned above, those rules are applicable to intermediaries offering third-party investment funds (a management company directly distributing its self-issued funds is not subject to MiFID) or structured notes. MiFID implementation is expected to provide for harmonisation of these rules.

The Life Insurance Directive allows Member States to require insurance undertakings to furnish additional information "*if it is necessary for a proper understanding by the policy-holder of the essential elements of the commitment*". Sales of unit-linked life insurance products are regulated by the Insurance Mediation Directive. However, the IMD is a minimum harmonisation Directive, and national regimes for sales of unit-linked life products are often more prescriptive than the IMD.

9 THE FINANCIAL SERVICES ACTION PLAN (FSAP)

The EC launched the FSAP in May 1999.

The FSAP is the initiative that the EC hopes would finally co-ordinate the delivery of a true EU cross-border market in financial services by filling in gaps in legislation and removing barriers.

The FSAP has three main aims:

- a single wholesale market,
- an open and secure retail market,
- state of the art prudential rules and supervision.

The FSAP contains no less than 42 separate legislative measures.

The integration of EU financial markets should bring significant benefits to businesses operators, investors and consumers.

It is in the area of retail financial services that most of the FSAP measures are meant to create a true single market, to overcome significant barriers, which include:

- home state product authorisations that prevent promotion of products in other EU markets,
- divergent registration and compliance requirements impacting on distribution cost,
- differences in the tax treatment between local and foreign products,
- registration barriers to enter the market in view to protect the local players,
- differences in regulatory approach between those states focused on products,
- inconsistencies in consumer compensation on a cross-border basis.
- These are the reasons for continuous complaint from the financial industry.

<u>Unfortunately, the legislative ambitions of the FSAP are undermined by Low and inconsistent implementation across Member States and an integrated European financial market will be impossible without tackling this issue.</u>

9.1 INSURANCE MEDIATION DIRECTIVE

On 30th September 2002 the EU Council of Ministers approved the IMD, which allows insurance intermediaries such as insurance agents, brokers and banks to market their services across Member State borders.

The Internal Market has largely been completed for insurance companies. Since July 1994, under the system set up by the Third Life (92/96/EEC) and Non-Life (92/49/EEC) Insurance Directives, insurance companies have been subject to a single set of administrative authorisation and prudential control arrangements imposed by the Member State where they are based.

This **"European passport"** enables the insurance company to carry on business anywhere in the EU, either under the rules on establishment or under the rules on the freedom to provide services (Articles 43 and 49 of the EC Treaty).

This single market legislative framework has facilitated the growth of cross-border insurance activity but has not yet had a significant impact on the total amount of individual business written.

This is partly due to the fact that insurance service providers who operate legally in one Member State are discouraged from expanding their business into another Member State by stringent requirements imposed by the host Member State under pretext of consumer protection.

Starting January 2005, intermediaries are meant to benefit of the freedom of establishment to provide services anywhere in the Internal Market, if they fulfill legal requirements in their own home country.

<u>The IMD requires that all intermediaries register in their home Member State and meet strict minimum requirements to be free to sell their services anywhere in the EU.</u>

The IMD requires that all individuals or companies (tied-up agents, multi-tied up agents, brokers or banks) who carry out insurance or reinsurance mediation be registered in their home Member State on the basis of the following minimum requirements:

- possession of appropriate knowledge and ability as determined by the regulations applicable in that Member State,
- being of high repute,
- possession of professional indemnity insurance or any other comparable guarantee against liability arising out of professional negligence (at least €1,000,000 per claim and €1,500,000 per year for all claims),
- sufficient financial capacity to protect customers against any failure by the intermediary to transfer customers' premiums to insurance companies or to pass on to customer’s money received for claims under the policies they hold.

These minimum requirements guarantee a high level of professionalism and competence.

Member States may adopt more stringent provisions, but only for intermediaries registered on their territory. On the basis of their registration in the home country, insurance or reinsurance intermediaries will be able to operate in other Member States, subject to the local marketing or consumer protection requirements.

The Directive also requires insurance intermediaries to give customers clear explanations for the advice they give on which products to buy. They need to specify accurately in writing, in terms comprehensible to the customer, why they recommend particular products in the light of the customer's individual requirements. Language is likely to be a key issue here.

The Directive allows Member State financial authorities and other bodies (i.e. professional associations) to be involved in the registration process by, for instance, registering insurance intermediaries under the supervision or control of the competent authority of that State.

Finally, the Directive encourages Member States to set up appropriate and effective Alternative Dispute Resolution procedures for out-of-court redress for dissatisfied customers.

Intermediaries are not the main distribution channel in many EU markets, it may be that the intermediary-led product providers from the more developed markets will need to give this process a kick-start by supplying favoured distributors with the requirements in target markets as they become available, and compliant products to sell.

9.2 UNDERTTAKINGS FOR COLLECTIVE INVESTMENTS IN TRANSFERABLE SECURITIES (UCITS) iii

The concept of UCITS was originally established by Council Directive 85/611/EEC on 20 December 1985. The scope of this initial Directive was restricted to Collective Investment Undertakings (CIU's) of the open ended variety which promote the sale of their units to the public in the EU. The range of underlying investments was restricted to 'transferable securities' (basically shares and bonds). The objective was to provide a mechanism for investment funds to be freely marketable within the EU.

However, the term 'transferable security' was not defined in the Directive hence different Member States applied different definitions and interpretations. This had a detrimental effect on achieving the objective of such funds being freely marketable within the community.

As a result the original UCITS Directive was amended by two new Directives under the UCITS III banner:

- 2001/108/EC, the Product Directive, extends the range of financial instruments in which UCITS may invest,
- 2001/107/EC, the Management Directive, relates to the regulation of management companies and provides them with a European Passport to

operate throughout the EU, as well as extending the range of activities they are permitted to undertake.

Both the new Directives became effective on 13th February 2002 and were required to be adopted by Member States by August 2003, and fully implemented by 13th February 2004.

9.3 THE PRODUCTS DIRECTIVE

Whereas the original 1985 Directive did not define the term Transferable Security the new Products Directive now provides a definition:

- shares in companies and other securities equivalent to shares in companies (“shares”),
- bonds and other forms of securitised debt (“debt securities”),
- any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange, excluding certain techniques (e.g. futures and options).
- As well as providing this definition the scope of permissible investments has been extended to include:
- **Money Market Instruments** - Instruments normally dealt on the money markets which are liquid, and have a value which can be accurately determined at any time,
- **Funds of Funds** - It is now possible to have a UCITS fund of funds, previously it has only been possible for a UCITS to have a limited investment in other UCITS and CIUs,
- **Bank Deposits** - UCITS are now able to make deposits with credit institutions, and hence create cash funds, provided that they are payable on demand or mature within 12 months. The institution must have its registered office in a Member State or, if not registered in the EU, be subject to equivalent prudential rules of an EU Member State,
- **Derivatives** - Previously the use of derivatives was only permitted for the purposes of efficient portfolio management or for currency hedging. Under the Product Directive it is now also possible to invest in derivatives as part of the UCITS investment policy,
- **Index Funds** - As a result of the Product Directive it is now possible to establish Index Tracker Funds. In order to achieve this it was necessary to widen the risk spreading rules for UCITS investing in shares and/or debt securities. The Product Directive requires the index to be sufficiently diversified, represent an adequate benchmark for the market it refers to and be published.

9.4 THE MANAGEMENT DIRECTIVE

The original UCITS Directive puts into place the system of EEC/EU passports for UCITS themselves but not for their management companies. The Management Directive brings management companies into the legislation and introduces the concept of UCITS management companies being granted an EU passport.

As soon as a Management Company is duly registered as authorised in its home country it can offer its services, either directly or through a branch, in any other Member State. The authorisation and regulation of the fund manager will fall within the home Member State's responsibilities.

In order to facilitate management companies passporting their services to other states the Management Directive has established a prudential supervisory regime, with which all UCIT management companies must comply in order to maintain their authorisation. Such a regime includes, for example, requirements for administration and accounting procedures, with adequate internal controls and the management enjoys a High reputation.

Additionally a Management Company is required to hold certain minimum levels of capital – broadly this equates to €125,000 initially plus 0.02% of assets under management in excess of €250m but with a cap on the capital of €10m.

The Management Directive, with the aim of aiding management companies 'to achieve important economies of scale', extends their activities to include the management of funds other than collective investment schemes.

A Management Company is allowed to delegate certain operations (e.g. marketing or administration functions such as legal and accounting services) provided the home state regulator is informed. The entity to which the delegation is made must be qualified to carry out such activities and the Management Company must ensure it monitors the outsourced activity effectively. In addition there are a number of pre-conditions prescribed by the directive in order to safeguard the strict applicability of the UCITS. Specifically a Management Company is able to delegate functions to such an extent that it becomes a 'post box entity' and hence supervision of the entity becomes 'difficult'.

The Management Directive also simplifies the marketing of UCITS and, whilst a full prospectus must still be produced, it allows the production of a simplified prospectus which is more investor friendly, being clear, concise and easily understandable, and containing all the key facts about a UCITS fund. An investor must be offered the simplified prospectus prior to the conclusion of the sale, as well as sign-posting that a more detailed full prospectus is available.

The simplified prospectus would be able to be used in all Member States without alteration, except for translation into the relevant languages.

The UCITS Directives had to be adopted by the Member States before August 2003 and all the changes fully implemented by 13 February 2004. Member states were allowed to grant existing UCITS a period, up to 13 February 2007, to comply with the new UCITS III directive. At that date the existing UCITS will either have to comply, be wound-up or converted into a non-UCITS fund.

Passporting is likely to lead to an increased supply of cross-border funds but at the same time UCITS III is likely to drive consolidation of fund ranges and lead to an increase in cross border mergers, with financial service companies with a real presence in each market benefiting from the changes in the market.

However, the reality is a bit different and many Member States have lagged behind in even introducing the legislation with Belgium, the Netherlands and Greece missing the February 2004 deadline. This is just one clear sign UCITS III has not yet taken off in a big way as suggested by some of the initial research findings.

Furthermore, the continuing discriminatory tax practices of certain member states constitutes a barrier against true cross-border funds industry unless altered. The EC has stepped up its efforts to fight such practices.

There were also a number of unresolved practical issues surrounding the UCITS III Directives relating to the simplified prospectus and the need provision of further guidance from the EU on the detailed interpretation of the laws.

Many of these issues were resolved when the EC published its long awaited guidelines relating to the implementation of the UCITS III Directives in April 2004. The objective of these guidelines is to help Member States interpret, in the same way, the rules in relation to investments in derivatives by UCITS and how fund managers should present the details of their funds in a Simplified Prospectus.

Given the nature of derivatives, the risks associated with such investments can be significant.

The EC’s guidelines set out clear rules and principles to underpin robust risk management standards related to derivatives, thereby ensuring that UCITS will be able to cover the liabilities incurred as a result of trading in derivatives and hence protect investors.

The Simplified Prospectus guidelines set out key components that fund managers are expected to make available to investors. The prospectus is expected to contain basic information about the fund (such as investment objectives and risk profile) as well as standard information to enable investors to compare information on different funds. This standard information includes Total Expense Ratio (TER) to enable investors to compare operating costs and a ‘portfolio turnover rate’ which indicates the fund’s volume of transactions.

Member States are expected to inform the EC the procedures they intend to implement to apply the Guidelines. The EC may adopt further measures to consolidate pan-European implementation.

The content of the guidelines were broadly welcomed by EFAMA (the pan-European trade body) but the EC was criticised for issuing the requirements as guidelines because these are not binding and Member States are not obliged to apply them. Hence uncertainty will remain as to how Member States intend to implement the guideline requirements.

Prior to the publication of the guidelines, the EC had already been severely criticised for the Low implementation of the UCITS III directives.

EFAMA accused the EC of providing insufficient guidance with regard to standard implementation, the result being that some countries did not take steps to incorporate the directives into their domestic legislation, whilst others interpret the rules in non-standard ways.

Many Member States had been well ahead of the game in introducing UCITS III but the lack of clarity prevented them from fully implementing the Directives until the EC published its guidelines. The UK, as one such State, introduced UCITS III legislation well in advance of the deadline but still has not finalised its rules pertaining to the simplified prospectus due before the end of 2004.

9.5 DISTANCE MARKETING DIRECTIVE

In 1998 the EU proposed a new directive to establish a harmonised and appropriate legal framework for selling financial services 'at a distance' while ensuring an appropriate level of consumer protection. This Directive intends to supplement the European Parliament and Council Directive 97/7/EC, which ensured appropriate consumer protection in respect of most products and services other than financial services which were excluded in view of their specific characteristics. Its aims are to rectify this omission by establishing common rules to govern the conditions under which distance contracts for financial services were concluded. It also proposed to amend Directive 90/619/EEC on life assurance and Directive 98/27/EC on actions for injunctions.

The Directive covers for retail financial services contracts (banking, insurance and investment services, including pension funds) negotiated by any means which do not require the simultaneous physical presence of the parties to the contract (i.e. at a distance) such as telephone, fax , internet or direct mail.

On the 23 September 2002, following a consultative period and two readings within the European Parliament the new Directive 2002/65/EC was issued.

The main features of the Directive are:

- the prohibition of abusive marketing practices seeking to oblige consumers to buy a service they have not solicited,

- rules to restrict other practices such as unsolicited phone calls and emails.

Two options have been provided to Member States with respect to the use of 'cold calling' and 'spamming'. The first option ("opt-in") prohibits cold calling and spamming unless the consumer has expressly consented and the second option ("opt-out") prohibits cold calling and spamming only if the consumer has given their objection by entering their name on a register set up for this purpose. The EC favours opt-in, but many Member States prefer the more industry-friendly opt-out approach,

- an obligation to provide consumers with comprehensive information before a contract is concluded.

- this package should include the identity, contract details etc. of the supplier, the price and payment arrangements, contractual rights and obligations as well as information about the performance of the service offered,

- a consumer 'right to withdraw' from the contract during a cooling-off period – except in cases where there is a risk of price fluctuations in the financial market.

Consumers have the right to cancel a contract within 14 days after signing up, extended in the case of life assurance and pension plans to 30 days. Individual Member States may also exclude mortgage or property credit from this right of withdrawal along with already exempt financial services subject to fluctuations in the financial markets such as foreign currency and securities. Information on the existence or absence of a 'right to withdraw' is required to be given to the client as part of the package detailed above.

The Directive has been seen as an essential part of a strategy to develop an Internal Market for retail financial services. This strategy was set out in the EC Communication on e-commerce and Financial Services and aims to create a regulatory environment that encourages the development of e-commerce in financial services and to build consumer confidence. The Directive should be applied in conformity with other directives such as the e-commerce Directive, 2000/31/EC, which was adopted in January 2002.

Although they are various exclusions to the requirements of the Distance Marketing Directive and it only applies to distance it is likely that most financial services product providers will adopt its requirements as a minimum standard.

This is because in the case of intermediary sales the product provider can not be sure that the sale was not carried out 'at distance'. Furthermore in the case of large financial groups the Distance Marketing Directive will apply to some areas of the business and the parent company will want to see a consistent application across the business.

9.6 TAXATION OF SAVINGS INCOME DIRECTIVE

The EU has been looking for more than 10 years for ways to curb what it sees as widespread tax evasion and fraud on non-resident savings by its citizens.

The Helsinki European Council in December 1999 established the principle that "*all citizens resident in a Member State of the EU should pay the tax due on all their savings income*". This principle is made up of 3 key elements which, in summary, say that:

- Member States should share information about residents' income,

- all types of savings income are to be covered e.g. bank interest, bond interest and distributions from collective investment vehicles,

- tax should be paid on all savings income from domestic and foreign sources (whether EU Member State or not). The Helsinki conclusions also recognised that, for successful adoption of any relevant directive, it was essential that “*equivalent measures are applied in third countries and dependent or associated territories with important financial markets*”.

The approach to this problem has divided governments for over 10 years, despite concerted efforts, and EU finance ministers have had considerable difficulty reaching an agreement on cross-border savings taxation, either by exchange of information or through withholding taxes.

The major stumbling block has been the requirement for unanimous approval of all EU governments on tax matters.

The EU ended years of stalemate on 21 January 2003 by reaching a compromise agreement on new rules on the taxation of its residents' savings invested abroad at the Council of Economics and Finance Ministers in Brussels:

- 12 countries, including the UK and Ireland, have implemented automatic exchange of information on non-resident’s savings from 1 July 2005,
- 3 countries (Luxembourg, Austria and Belgium) are not to exchange information but instead to levy a ‘retention and withholding tax’ of up to 35%. Transitional arrangements are expected to allow a withholding tax of 15% on non-residents' savings from 1 July 2005, rising to 25% from 1 January 2007 and to 35% from 1 January 2010, sharing the revenue with the country of residence (handing over 75% and retaining 25%).
- Luxembourg, Austria and Belgium are not obliged to move to information exchange from 2011, contrary to OECD requirements. Instead, a unanimous vote of all member countries will be required, giving each of the three countries an effective veto. It is to be noted that this depends on the US, Switzerland, Liechtenstein, Monaco, Andorra and San Marino also adopting automatic exchange of information.

The Taxation of Savings Income essentially required **paying agents** to report information regarding **savings income payments** to **relevant payees** and residual entities from 1st July 2005.

9.7 PAYING AGENTS

A paying agent is a person who in the course of his business or profession

- makes a savings income payment to,
- or secures a savings income payment for,
- the immediate benefit of an individual resident (according to scheme rules) in a prescribed territory or a residual entity.

9.7.1 Relevant payees

A relevant payee is an individual resident in a prescribed territory who receives a savings income payment from, or for whom a savings income payment is secured by, the paying agent.

9.7.2 Savings income payments

There are four main categories of savings income under the scheme, including definitions of interest payments that may not be obviously classed as interest.

Broadly, these are:

- interest paid out on debt-claims or credited to accounts e.g. interest on bank or building society. Interest payments on government and corporate bonds and interest on certificates of deposit,

- interest rolled-up and paid out when a debt-claim is repaid or sold e.g. accrued interest or discounts on Treasury Bills, commercial paper or other money market instruments, zero-coupon bonds or other discounted securities. The category includes accrued interest or discounts included in the price when securities are sold to a new holder as well as when they are redeemed by the issuer,

- distributions made by collective investment funds which have the requisite proportion of their investments in debt-claims e.g. Income paid out, reinvested in new units or added to existing units by collective investment schemes, which have invested more than 15% of the fund in debt claims ,

- accumulated income paid out when units in a collective investment fund which has invested the requisite proportion of its investments in debt-claims are redeemed or sold e.g. accrued income included in the redemption (or sale) price of units issued by collective investment schemes, which have invested more than 40% of the fund in debt-claims.

9.8 COLLECTIVE INVESTMENTS FUNDS

While the reporting requirements for the types of deposit listed under (a) and (b) above seem relatively straight forward, the implications for collective investment schemes under (c) and (d) are somewhat more complicated.

The main type of collective investment funds concerned will be UCITS (Undertakings for Collective Investment in Transferable Securities, authorised in accordance with Directive 85/611/EEC) which, in the UK for instance, may either be authorised unit trusts or open-ended investment companies.

Paying agents also have to report payments which are derived from income payments made by, or from the proceeds of the sale or redemption of units in, collective investment funds based outside the UK, including funds based outside the EU.

The term 'fund' refers to any type of collective investment fund irrespective of its base or legal form and 'unit' to any unit or share certificate in a fund.

The introduction of this Directive is causing considerable headaches for the individuals involved. In addition to ‘relevant payees’ needs to structure their cross border finances accordingly many financial institutions have considerable requirements to changes IT and reporting systems.

9.9 MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID)

9.9.1 Overview

MiFID was due to be implemented in EU Member States by 1st November 2007. It replaces the Investment Services Directive (ISD), but goes much further than the ISD in terms of creating an effective single market in investment services.

One of the reasons behind the need to replace the ISD is that, since it was finalized in 1993, the financial markets have developed significantly and certainly far beyond the scope envisaged by the ISD. For this reason, an important area where MiFID expands on the scope of the ISD is in the area of commodity derivatives. At present, EEA Member States choose to regulate commodity derivatives in different ways. Firms which belong to non-commodity groups, such as banking groups with commodities arms, will be among those that feel the effect of this change.

9.9.2 Scope of MiFID

The precise scope of MiFID has been subject to much debate, and, as already noted, is yet to be finalized. However, we do know that the following will be within its scope:

- options, futures, swaps, forward rate agreements, and any other derivative contracts relating to commodities that may be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event).

- options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or a multilateral trading facility.

- options, futures, swaps, forwards and any other derivative contract relating to commodities, that can be physically settled not otherwise than mentioned in 2 above and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls.

- other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or a multilateral trading facility, are cleared and settled through recognised clearing houses or are subject to regular margin calls.

Other derivative financial instruments are also included within the scope, including some, such as freight rates and emissions that may also be of relevance to commodity firms.

MiFID has been written in such a way as to try to anticipate and cover developments in the financial markets by being drafted in broad terms. The fourth category shown above therefore amounts to a sweep-up designed to cover types of instrument not expressly referred to, and perhaps not in existence at the time MiFID was drafted.

9.9.3 How does MiFID work?

The basic structure of MiFID is recognizable enough to anyone familiar with the ISD. Like the ISD, MiFID distinguishes between "core" and "non-core" investment services, although under MiFID these are known respectively as "investment services and activities" and "ancillary services".

Under MiFID, a firm which performs only ancillary services is not a MiFID firm. If, however, it carries on investment services and activities, it is subject to MiFID in respect of both those investment services and activities and any ancillary services which it also carries on, and it can provide both those investment services and activities and those ancillary services in other Member States under the MiFID passport regime.

9.9.4 Key exemptions

9.9.4.1 Groups

Of general application is the group exemption for companies providing investment services exclusively for other companies in the same group. However, it is unclear whether this exemption apply to all intra-group principal-to-principal dealings, because the exemption refers only to "investment services", and not to "investment services and activities".

9.9.4.2 Dealing on own account

There is also an exemption for persons who only deal on own account. However, this exemption does not apply, and so firms will be caught by MiFID, if they are market makers, or if they deal on own account outside a regulated market or multilateral trading facility on an organized, frequent and systematic basis by providing a system accessible to third parties in order to engage in dealings with them. Again, exactly what this means is unclear, but it could catch arrangements where firms make dealing services available to counterparties and clients.

9.9.4.3 Commodities dealers

There are also important exemptions specific to commodity derivatives. Those whose main business consists of dealing on own account in commodities or commodity derivatives, and who are not part of a group whose main business is the provision of other investment or banking services, are excluded.

9.9.4.4 Ancillary business

In addition, those dealing on own account in financial instruments or providing services in commodity derivatives or derivative contracts of the type referred to in 4 above to the clients of their main business, are exempt, provided this is an ancillary activity to their main business when considered on a group basis. However, this exemption is not available to investment or banking groups. It is not clear what "ancillary" means in this context, but it probably means incidental to the main business of the group.

9.9.4.5 Non-clearing members

Also exempt are firms which are non-clearing members of a market who only: (1) deal on own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets; or (2) deal for the accounts of other members of those markets or make prices for them, and who in either case are guaranteed by clearing members of the same markets and where responsibility for performance of the firm's contracts is assumed by clearing members of the same markets.

It is also worth bearing in mind that, even where MiFID in general does apply, certain obligations, such as those in relation to pre- and post-trade transparency are excluded in relation to derivatives. However, this and a number of other aspects of MiFID are due to be the subject of further review, so firms should monitor developments in this area.

9.9.5 Client classification under MiFID

One of the more tricky areas of MiFID is in the area of client classification.

MiFID sets down a three-tier system of client classification. The full range of protections applies to private customers - retail customers as they are known under MiFID. More limited rules apply to clients classified as professional clients (such as financial institutions, large undertakings and government bodies), with a still-lighter regime for eligible counterparties.

Eligible counterparties include other investment firms, banks, insurance companies, UCITS and their management companies, pension funds and national governments.

However, the categorization of a client as an eligible counterparty does not apply to all types of investment service. The carve-out in relation to eligible counterparties applies only in relation to the activities referred to in Article 24(1) MiFID, namely executing orders on behalf of clients, dealing on own account, and receiving and transmitting orders. In relation to investment advice or portfolio management, for example, the same client would have to be categorized as a professional or retail client.

Also, being an eligible counterparty still leaves significant obligations under MiFID, such as the requirements of Article 18 MiFID in relation to conflicts of interest, and the client money obligations.

9.9.6 MiFID — Investment firm branch issues examined

Under the Investment Services Directive investment firms that are authorized in one Member State may provide investment services in other Member States. The investment firm may do this without having to be authorized separately in each Member State in which they do business either cross border or through a branch. This is known as the “passport”.

The requirements for authorization in Directive 2004/39/EC (MiFID) are set out in Article 5 which provides that an investment firm must be authorized by its Home Member State regulator. Article 4(20) MiFID provides that the “Home Member State” is where the investment firm’s registered office is situated or if it has no registered office under its national law, the Member State in which its head office is situated. Article 4(21) MiFID defines a “Host Member State” as a Member State other than a Home Member State in which an investment firm has a branch or where it performs services or activities.

Article 4(26) MiFID sets out a technical definition of the term “Branch”. This provides that it is an investment firm’s place of business other than its head office which has no legal personality and which provides investment services and/or activities and which may also perform ancillary services for which the investment firm has been authorized. The definition also provides that all the places of business set up in the same Member State by an investment firm with headquarters in another Member State shall be regarded as a single branch.

Article 31 MiFID places a requirement on Member States to ensure that authorized investment firms may freely perform investment services and activities as well as ancillary services within their territories. The caveat to an investment firm’s freedom is that such services and activities must be covered by its authorization and that ancillary services may only be provided together with an investment service or activity.

Article 32 MiFID places a requirement on Member States that they shall ensure that an investment firm may provide investment services through a branch provided that such services are covered by the investment firm’s authorization granted by the regulator in its Home Member State and that any ancillary services are only provided together with investment activity. The second paragraph to Article 32(1) MiFID then provides that Member States shall not impose any additional requirements on the organization and operation of an investment firm’s branch except as set out in Article 32(7) MiFID. Article 32(7) MiFID provides that the branch will be subject to the rules of conduct laid down in Articles 19 (conduct of business obligations when providing investment services to clients), 21 (obligations to execute orders on terms most favorable to the client), 22 (client order handling rules), 25 (obligation to uphold integrity of markets, report transactions and maintain records), 27 (obligation for investment firms to make public firm quotes) and 28 (post trade disclosure by investment firms) MiFID of the Member State where the branch is situated.

What does this mean in practice for passported investment firms? Where an investment firm provides services on a purely cross-border basis Home State conduct of business and organizational requirements will only apply. For an investment firm which establishes a branch in another Member State, the branch will be required to comply with Home State organizational requirements but in relation to the activities carried out in the Host State the investment firm will need to comply with Host State conduct of business requirements. Where a passported branch provides services outside the territory of its Host State, it seems, somewhat bizarrely, that Home State conduct of business requirements will apply.

In practice how would this look? Take for example investment company A which is authorized in the UK but has a branch in Paris which provides investment services to clients in France and also provides investment services cross border in Luxembourg. Under MiFID the investment services conducted in Paris by investment company A's Paris branch would be subject to UK organizational requirements but must comply with French conduct of business requirements. In relation to the investment services which investment company A's Paris branch provides to clients in Luxembourg, UK and not French conduct of business requirements will apply.

Using another example investment company B that provides investment services cross border from the UK to France will only be subject to UK conduct of business requirements. This is a significant change from the position under the Investment Services Directive and may lead many firms to consider whether it would be worthwhile restructuring their delivery of services to take account of the benefits of this change.

Some commentators have observed that certain jurisdictions may not be able to implement MiFID into their national legislation within the current legislative timetable. This then begs the question of what the organizational and conduct of business requirements will be for those branches where its Home State has implemented MiFID on time but its Host State has not or vice versa. Testing times may be ahead.

9.9.7 Passporting

The late passporting regime, under the 1993 Investment Services Directive, was replaced on 1 November 2007 by MiFID. This raises a number of transitional questions, such as:

- Will firms be able to continue to exercise passporting rights as they have under the ISD?
- Will they be able to use the MiFID passport (which extends to services, such as investment advice, which are not core services under the ISD) into Member States that have not yet implemented MiFID?
- Will firms wanting to passport from a Member State that has not yet implemented MiFID be able to do so?

The short answer is that the position is unclear, and may well come down to the approach adopted by the authorities in each of the relevant Member States. It is therefore to be hoped that the EC takes action to ensure that firms are not prejudiced by the failure of a Member State to implement MiFID on time.

9.9.7.1 Home / host issues

It is not just firms that are likely to be confused by a patchwork of MiFID and non-MiFID regimes - such a scenario raises practical issues for the competent authorities in each Member State as well. For example, under MiFID, the Home State regulator of a firm is also responsible for regulating the conduct of MiFID business on a cross-border basis into other Member States.

This includes cross border business carried on from a branch. So a German firm having a branch in Sweden, from which services are provided into other Nordic States would be subject to German regulation of conduct of business in all States other than Sweden. If, however, one or more of those Nordic States has not yet implemented MiFID, the cross-border business would potentially be subject to two different and possibly conflicting sets of rules, and supervised by two different regulators.

There may also be uncertainty about transaction reporting and trade reporting, where firms may have to continue to report in States where MiFID has yet to be implemented, as well as to their competent authority under MiFID.

9.9.7.2 Practical steps firms should consider

Firms that currently operate cross-border under the ISD, or which plan to do so under MiFID, should therefore identify each of the jurisdictions that are relevant to them, and if possible assess the likelihood of that Member State implementing MiFID on time. They may then have to take legal advice in those jurisdictions on the possible implications of providing investment services in or into those jurisdictions at a time when that Member State has not brought its MiFID implementation measures into effect.

Similarly, firms who’s Home State have missed the MiFID deadline may need to consider the need for legal advice if they plan to use the passporting rights under MiFID before their Home State has implemented it.

10 EUROPEAN COMPLIANCE ISSUES

Sufficient attention should be paid in ensuring a high level of consistency between the implementation of the IMD and MiFID standards for instance when in most member states investment advice is exercised concurrently with insurance mediation.

It remains a hard task for the EC in view of the paltry enthusiasm of national civil servants (based mostly on the national legal frames) for anything that might represent the slightest change in their little practices or privileges…

As an example, red tape burden is estimated costing Britain's business alone £100bn a year, pushing the cost of compliance to 4% of operating expenses for large entities, up to 35% for Small and Medium Size Enterprises.
In addition, the divergent interpretation of basic EU principles by the national regulators causes a total lack of harmonisation in the application of EU rules at national level.

Across all countries and industry sectors, expanding regulations, overlapping mandates and tighter enforcement have elevated the cost of compliance.

The "time bomb", which in the very short term is constituted by the pensions problem, reinforces the political need to address the prospective problems sooner than later, even if the politicians are showing a certain reluctance for EU legislation, leaning towards a more liberal direction, and be more genuinely concerned with consumer interests, than certain national bureaucracies might wish.

The possible failure of the state pension systems will open unprecedented prospects for European financial advisers and intermediaries called upon to assist the anxious consumer in the right choice of options and alternatives for the sound management of retirement or inheritance assets.

In the meantime, politicians who may be willing to privatise health insurance or pension still insist for compulsory taxation on savings which makes the privatisation politically impossible.

EU legislation is broadly designed to create a "level playing field" throughout the financial services arena. In reality, however, many "local" hurdles continue to exist and this often frustrates the operating activities of product suppliers – despite the fact that national (basic) product requirements are consistent throughout the EU.

Local expertise and advice are essential in the monitoring of local legislation, the identification of opportunities and any subsequent distribution of products to promoters and distributors.

The lack of training and organization of certain financial advisers and intermediaries often creates problems and the industry must tackle the provision of quality training courses and ensure assistance for adviser and intermediary integration, in close co-operation with the national trade associations.

The EU proposal for a comprehensive legislation is a critical issue, as the EU wants, (and the action plan requires it), to elaborate a “consumer-focused” legislation.

The regulatory authorities are either public authorities or bodies recognized by national law or by public authorization expressly empowered for that purpose by national law. Member states shall designate the competent authorities empowered to ensure implementation of the Directives, therefore if the political willingness exists, joint-regulation could be the option selected.

10.1 HOW REGULATION APPLIES WITHIN THE EU

Country	Level of co-operation with the industry	Spirit of transposition	Level of costs	Level of compliance	Comments
Germany	Medium	High	Low	Low	Not a priority
Czech Rep.	High	High	Low	Low	Open mind
Poland	Low	High	Low	Low	Anti-EU attitude Local association(s) non efficient
Belgium	High	High	Low	Low	Open mind
Austria	High	High	Low	Low	Open mind
Ireland	High	High	Low	Low	Open mind
Great Britain	Medium	None	High	High	Anti-EU attitude
Spain	Medium	None	Medium	Medium	National protectionism Biased in favour of banks & other large institutions
Greece	Low	None	High	High	National protectionism Biased in favour of banks & other large institutions
France	High	None	High	High	National protectionism Biased in favour of banks & other large institutions
The Netherlands	Low	None	High	High	Biased in favour of banks & other large institutions
Luxembourg	Low	None	Low	High	Over regulated because of fear of looking like an offshore centre…
Scandinavian Countries	Low	None	High	High	Biased in favour of banks & other large institutions
Portugal	Low	None	Low	Low	Biased in favour of banks & other large institutions
Cyprus	High	None	Low	Low	Open mind
Switzerland	High	N/A	High	Low	Self regulation
Italy	Medium	N/A	High	Medium	N/A

10.2 THE SUPERVISION WITHIN THE EU

10.2.1 Introduction

Traditionally, EU legislation focused primarily on requirements for adequate administrative and internal controls systems in financial institutions. With the recent adoption of the MiFID, there is now an explicit requirement for investment firms and banks to establish a “permanent and effective” compliance function.

MiFID is one of the first, and definitely the most expensive, piece of legislation to be subject to the “Lamfalussy procedure”: whereby “Level 1” legislation is adopted through the traditional co-decision procedure (involving the European Council and the European Parliament) and the Level 2 legislation is developed by the EC, upon advice from a Lamfalussy committee – in this case, the Committee of European Securities Regulators (CESR) – and in collaboration with the European Securities Committee (comprising representatives of national governments).

CESR’s advice includes principles relating to the compliance function, compliance policies and procedures, and compliance oversight. MiFID, however, also establishes high-level organizational and conduct of business standards, covering classification and suitability requirements for customers.

There are no similar requirements, as yet, at the EU level for insurance companies.

10.2.2 Anti-money laundering (AML)

Two community directives have been adopted in the field of AML, the first in 1991 and the second in 2001. The first directive made the reporting of money laundering an obligation and required financial institutions to identify and know their clients, to keep appropriate records, and establish AML training programs. The second directive extended the scope of the directive beyond the financial sector (i.e. asset managers, insurance undertakings, investment firms and credit institutions) to embrace professions such as accountants, external auditors and lawyers.

In June 2004 the EC proposed a third AML directive. The EC issued the draft directive in order to align EU standards fully with Financial Action Task Force on Money Laundering (FATF) 40 recommendations. Inter alia, it subjects insurance intermediaries to equivalent requirements to those imposed on other financial services intermediaries.

Austria

The requirement for an independent compliance function were introduce in 1993 on a voluntary basis based on a self regulation of the sub-organizations for credit institutions, insurance companies and pension fund associations within the Austrian Chamber of Commerce. There currently no legal requirements for the appointment for a compliance officer or establishment of compliance function. The main principles are:

- definition of restricted areas which will normally deal with sensitive information,

- listing and monitoring of restricted securities (i.e. securities which must be traded by the company or its employees),

- listing and monitoring of monitored securities (trades in these securities will be investigated by the compliance function).

Currently, the activities of the compliance function are limited mainly to the prevention of insider trading or other prohibited transactions as defined in the Austrians in the Austrian Securities Exchange Act and Austrian Securities Supervision Act.

Austrian AML regulations adopted EU standards in 1993. The most recent amendment was in 2003 when the second EU AML directive was transposed. These regulations specify the appointment of an independent AML compliance officer, who shall not have wider compliance responsibilities.

In a circular in March 2004, the Austrian Financial Market Authority (FMA) stated that, in principle, the AML compliance function and internal audit must not be fulfilled by one organizational unit/person.

Nevertheless they admitted that – depending on the size of the entity, the number of employees, the business conducted, and the number and complexity of transactions relevant for Compliance and/or AML – these functions could be conducted by one person, provided that an independent review is undertaken.

The FMA is currently in discussions with industry as to its understanding of the compliance function requirements in the context of MiFID. These new rules are expected to lead to significant change in the meaning of compliance in Austria and, therefore, will impact the approach to compliance functions.

Belgium

The Banking, Finance and Insurance Commission (CBFA), created through the integration of the insurance Supervisory Authority (OCA) into the banking and Finance Commission (CBF), has been the single supervisory authority for the Belgian financial sector since 1 January 2004.

In Circular D1 2001/13, the CBFA set out its position on the organization of a comprehensive compliance function in credit institutions, enumerating ten principles. The circular requires credit institutions to set up an independent compliance function with the aim of ensuring that the firm complies with the rules relating to banking “integrity”. It identifies the areas to which the integrity policy should give priority. The executive committee is responsible for drawing up an integrity policy and the board of directors is responsible for its adequacy. At least once a year, the executive committee reports to the board of directors on the compliance, through the audit committee if one exists.

The circular stipulates that professional competence, integrity and discretion are essential qualities of the compliance staff for the proper functioning of the compliance function.

In November 2002, the Belgian regulator issued a similar circular stipulating that the compliance function in investment firms should be independent: in March 2005, similar requirements were imposed on insurance companies.

These circulars are supplemented by a June 2004 circular which confirmed that the compliance requirements apply to credit institutions and investment firms in terms of all outsourced activities.

Prior to 2001, requirements for a limited compliance function were established for all financial institutions (banks, investment firms and insurance companies) by the AML law of 11 January 1993, which inter alia, required the appointment of a compliance officer. Similar requirements relating to “special mechanisms” (anti-fraud and tax evasion) were also in effect at that time. The law of 11 January 1993 transposed the first EU AML Directive (91/308/EEC).

The second EU Directive (2001/97/EC) was transposed by the Law of 12 January 2004. Article 21bis of this law provided that the CBFA should define the specific implementation rules applicable to institutions it supervises and these rules were promulgated by the CBFA circular of 27 July 2004 which was subsequently approved by the Royal Decree of 8 October 2004.

Czech Republic

Financial market supervisory authorities were integrated into the Czech National Bank (CNB), in 2006. After implementation of MiFID, all institutions (such as investment firms, investment intermediaries) are obliged to guarantee compliance. One of compliance´ responsibility is also the AML area.

For the need of implementation of respective European regulation (Directive 2005/60/ES, Directive 2006/70/ES, Regulation 1889/2005 and Regulation 1781/2006) the new Act has been created in Czech Republic during 2008 (Act nr. 253/2008). By passing the Act 253/2008 Czech Republic has implemented all requirements in anti money laundering area resulting from “40 recommendations” and “9 specific recommendations” of FATF in actual version. Czech Republic is not a direct member of FATF, but it is engaged to its activities on the basis of EU membership.
Supervision in AML area is brought into effect by CNB and Ministry of Finance (special authority – FAU). The main responsibilities are:

- possibility of control
- possibility of sanction
- secondary legislation power

France

The Autorité des Marchés Financiers (AMF), the French regulator of investment firms, was the first regulator in France to establish requirements regarding compliance agreements.

The General Regulation requires that a "déontologue" is appointed in each entity that is responsible for the definition, and implementation, of conduct of business rules throughout the institution.

Recently, the Commission Bancaire, the French banking regulator, issued a series of proposals on compliance arrangements. Those proposals apply to both banks and investment firms, as the Commission Bancaire supervises both groups of institutions. These form part of the current regulation on internal controls (Regulation 97-02).

The proposals introduce a definition of "non-compliance risk", based on the Basel Committee's definition as set out in October 2003 consultation paper. AML is included within the scope of non –compliance risk although not explicitly. The main proposals are the following:

- appointment of a dedicated and independent compliance officer,
- implementation of a compliance monitoring program,
- implementation of specific procedures with respect to new products approval,
- implementation of specific procedures in terms of breach identification, escalation process and record-keeping,
- implementation of a non-compulsory whistle-blowing process (i.e. each employee must be given an opportunity to blow the whistle if he/she deems this necessary, but must be under no compulsion to do so).

Germany

Germany's financial services regulators merged into a single entity during 2002, forming the Federal Financial Supervisory Authority (BaFin). BaFin is responsible for the supervision of financial institutions, including insurance undertakings and pension funds, and the regulation of securities trading and the investment business (investment companies). The supervision of financial services institutions is dual faceted, split between solvency and market supervision.

Italy

The Bank of Italy and CONSOB regulate the banking and securities sectors in Italy. The insurance sector is supervised by ISVAP. The three supervisory bodies, especially Bank of Italy, have clearly defined the internal control framework for the Italian companies, but requirements regarding compliance monitoring as an activity within the internal audit function and related processes.

Bank of Italy is about to issue a new circular which will regulate the Investment and Asset Management companies operations in accordance with UCITS III directive. The draft circular states that the internal audit function has to perform the activities connected with the “compliance function”.

Luxembourg

The Commission de Surveillance du Secteur Financier (CSSF) supervises the financial services sector in Luxembourg, including credit institutions, investment firms, investment funds and pension funds. On 27 September 2004, following consultation with industry, the CSSF issued a circular (CSSF 04/155) providing detailed guidelines for the setting up of a compliance function in banks and investment firms. This is mandatory in all Luxembourg banks and investment firms as from 1 January 2006.

The introduction of a compliance function does not lead to an additional level of supervision. Rather it aims at ensuring proper co-ordination, organization and structuring of controls, already carried out in accordance with the provisions of the circular on internal control, but which are often split amongst different departments and handled at different organizational levels.

According to the circular, the board of directors must adopt a positive attitude towards compliance, ensure the effectiveness of the compliance function, and approve the compliance policy and the compliance charter defined by the management. The compliance policy must include the fundamentals of the compliance risk, clarify the broad principles for managing the compliance risk, define the compliance function, its objectives and independence, prescribe the charter process and define the training program. The compliance charter, communicated to the entire staff, governs the objectives and responsibilities of the compliance function. The compliance charter must include the compliance function’s objectives, responsibilities, independence and permanence, relationships with other units, access to all necessary information, reporting lines and access to the management bodies. Management is in charge of developing and implementing the compliance policy, as well as of setting up a compliance function which is in accordance with stated principles. Management must appoint one its members, whose name must be communicated to the CSSF, as the person directly in charge of the compliance function.

The circular also stipulates that the compliance function shall be independent from all commercial, administrative or control functions and shall exist on a permanent basis. It has the power to start investigations and controls on its own initiative, and has the right to access any kind of information. The institution has to designate an employee in charge of the compliance function, the “compliance officer”, whose name has to communicate to the CSSF. The compliance officer must, in principle, be dedicated on a full-time basis to the compliance function. Small-scale institutions engaged in low-risk activities are allowed to fulfil their compliance function on a part-time basis, with prior authorization from the CSSF.

Certain tasks assigned to the compliance function may be delegated to other services provided that such tasks are compatible with other tasks for which the personal of these services are responsible. In such cases, the compliance function assumes a coordination role between the services carrying out these tasks. In any event, the responsibility for the tasks remains with compliance function.

The Commissariat aux Assurances (CAA) supervises the insurance industry in Luxembourg. The CAA has not issued any specific regulations on compliance function for the insurance sector, as yet.

Imapct de l'industrie financière sur l'économie luxembourgeoise*

Valeur ajoutée	Total mio. euro	2006/2007	% PIB
Banques	9.554	-3 %	26 %
Assurances	1.170	6 %	3 %
PSF	2.095	33 %	6 %
Sociétés Gestion	3.409	20 %	9 %
Total	16.227	5 %	45 %
Rappel 2006	15.387		45 %
Emploi	**Total**	**2006/2007**	**% Emploi**
Banques	40.393	4 %	12 %
Assurances	5.598	1 %	2 %
PSF	17.886	21 %	5 %
Sociétés Gestion	7.602	3 %	2 %
Total	71.479	8 %	21 %
Rappel 2006	66.442		21 %

* Chiffres 2006 réctualisés selon les mises à jour des sources d'information ou modifications du modèle.
Source: Comité pour le Développement de la Place financière

The Netherlands

Financial markets are regulated by the Autoriteit Financiële Markten, the Financial Markets Authority (AFM), in so far as it related to market conduct supervision. Prudential requirements for banks, securities institutions, pension funds, investment institution and insurance companies are supervised by the Dutch Central Bank, De Nederlandsche Bank (DNB).

Investment institutions and securities institutions and credit institutions and credit institutions in the Netherlands are obliged by regulations to retain one or several compliance officer(s). The Regulations on Organization and Control (Regeling Organisatie en Beheersing or 'ROB') stipulate that the compliance function should be independent with direct reporting lines to the management board, and in case the integrity of the management board is in doubt the compliance officer should have access to a delegate of the supervisory board.

Although not mandatory, the compliance officer is expected to monitor and control the institution's activities, as well as consult on the implementation and interpretation of rules and regulations and advising management on compliance issues. There are only very limited rules for appointing a compliance officer and even though there are certification programs offered by commercial training entities for compliance officer they are not compulsory.

Under the Dutch act that covers AML (Wet melding ongebruikelijke transacties); there is no obligation to appoint a compliance officer. However, this is common practice as it is perceived that the task under the AML act are best performed by one person, in general or preferably, by the compliance officer.

Multi-channel Nederland			
Bankkantoren ▪ 570 kantoren ▪ 5800 FTE: - 3900 Retall - 1300 Prefarred Banking - 600 Speialisten ▪ 4,4 mil. clienten ▪ > 550.000 bezoekers per week	**Geldautomaten** ▪ 1550 geldautomaten ▪ > 2.000.000 transacties per week	**Call Center** 5 lokaties ▪ 1.077 FTE ▪ 32 mil. calls per jaar ▪ > 700.000 calls per week	**Internet** ▪ 2,9 mil. bezoekers per maand ▪ > 1.400.000 bezoekers per week
20% van de klantcontacten 80% van totale verkoop		80% van de klantcontacten 20% van totale verkoop	

Spain

In Spain, the supervision of the financial sector is carried out by the Bank of Spain (banking activities), the Spanish National Securities Exchange Commission (stock market and the General Directorate of Insurance and Pension Funds (insurance activities).

Under Spanish law applicable to financial entities, compliance requirements have traditionally applied within the regulatory regime in terms of the rules on conduct of business, conflict of interest, internal control and adequate level of administrative resources. According to this approach to the compliance function, Spanish general regulation on financial institutions provided general conduct of business standards, general principles on conflict of interest, and specific regulatory obligations regarding customer and operations. Since 2003 certain legislation focused on internal control resources, corporate governance, transparency and investor protection has been adopted accordingly.

Spanish AML rules have recently been modified to implement additional quality control measures such as enhancing corporate governance within the financial institutions' AML framework, particularly strict know-your-customer rules, and the adoption of qualified control and supervisory measures applicable to those high-risk areas within financial institutions according to the nature of their activities, and type of clients, amongst other things. Amongst the changes introduced by the new AML regulatory framework, financial institutions are now subject to a compliance review of their internal procedures by an external expert.

Sweden

Finansinspektionen (FI), an integrated regulator supervising all sectors in the Swedish financial services industry, was established in 1991.

There is a regulatory code (FFFS 2002:5-7) requiring all investment firms and banking institutions, licensed to conduct securities operations, to have a compliance function. An investment form must have one or more compliance officers who are responsible for ensuring that employees within the firm, and its board of directors to ensure that the compliance officer reports directly to them or to the company's management. Banks and insurance companies (regulatory code 1999:12 and 2000:3) are required to have an internal function that is responsible for the compliance with internal as well as external rules and regulations.

United Kingdom

The Financial Services Authority (FSA), the UK regulator, an integrated regulator set up by the Financial Services and Markets Act 2000, was established in 1997 and assumed full responsibility for the financial sector in 2001, succeeding the Securities & Investments board which was established in 1985.

Since the late 1980s, the vast majority of financial services firms in the UK have been required to have a compliance officer. An investment firm must allocate a director or senior manager as having responsibility for the oversight of the firm's compliance and should report directly to the firm's executive board. The compliance function is a "controlled function" in the United Kingdom, which means that a candidate proposed as head of compliance cannot be appointed until approval has been given by the FSA. The FSA must be satisfied that the person is fit and proper in accordance with the "fit and proper test for approved persons". Outsourcing compliance to external consultants is allowed, but responsibly rests with one or more directors or senior managers of the firm as head of compliance.

The compliance officer consults all business lines, and does not solely have control function. Compliance generally means respecting the Principles of Businesses and Senior Management, and rules for Conduct of Business (COB), the Collective Investment Schemes (CIS) and Money Laundering (ML). Heads of compliance will normally have responsibility for overseeing a firm's relationship with the FSA.
Compliance is defined by the FSA Handbook section "Senior Management Arrangements, Systems and Controls" Chapter 3 and Money Laundering sourcebook.

Switzerland

The Federal Banking Commission (SFBC) is the licensing and supervising body in Switzerland for banks and securities firms. The Swiss Banking Law is the main legal basis in regulating compliance. More guidance is included in SFBC circulars.

Compliance, as part of internal controls, was first mentioned in the circular on internal controls issued by the Swiss Bankers Association in 2002. In a SFBC circular, expected by mid 2005, banks and securities dealers will be required to establish a compliance function. However, the implementation of compliance functions is common practice nowadays in Switzerland. Due to its large community of international banks, national standards are strongly influenced by international best practice and the work of international standard setters.

The SFBC views compliance as a staff function: it should independent and should not have operational responsibilities. It should have direct reporting lines to the board of directors.

The AML Ordinance was due to be totally implemented by 30 June 2004. The implementation was audited and a separate report must be filled to the SFBC by 15 March 2005.

10.2.3 Financial service institutions - Market supervision

Looking at the financial services industry in Germany the term “compliance” is closely linked to all issues regarding the securities sector and investor protection. The basis for supervision, and the groundwork for investor protection, is provided by the rules of business conduct for investment services enterprises set out in the Securities Trading Act (WpHG).

A further fundamental component of market supervision is supervision in accordance with the Safe Custody Act (DepotG). For financial services institutions, whose regular business is the provision of investment services (investment firms); the compliance function has been a part of the regulatory regime since 1994 when certain rules for staff transactions came into force.

The role was further developed in the Securities Trading Act (WpHG) and corresponding supervisory guidelines covering organizational requirements and rules of contract. Since 2002, BaFin also monitors securities analysis provided by investment firms. In October 2004 Germany transposed the European Directive on insider dealing and market manipulation (Market Abuse Directive) establishing organizational duties and rules of conduct for all kinds of financial analysts creating and distributing investment recommendations.

Compliance function structures, and compliance processes, are governed by the BaFin guideline on organizational duties pursuant to Sec 33 WpGH. These include, for example, obligations for companies to maintain the necessary level of resources for the compliance function, and obligations for addressing conflicts of interests. The compliance function should fit to the nature and structure of the investment firm’s business (es). Detailed minimum requirements are stipulated. The compliance function should be a standalone department. Irrespective of the functions of the compliance office, the overall responsibility for compliance remains with the management.
BaFin monitors compliance with the rules of business conduct and the Safe Custody Act. External auditors undertake annual audits of financial institutions, checking compliance. BaFin evaluates the resulting audit reports.

Beyond the securities sector, there are only few specific requirements relating to compliance, but more extensive requirements relating to internal control.

10.2.4 Solvency supervision

The groundwork for internal control and compliance (in a border sense) is provided by sec. 25a of the Banking Act (KWG) supplemented by several BaFin guidelines. The three major ones i) Minimum requirements for the Trading Activities of Credit Institutions (MaH, 1995), ii) Minimum requirements for the credit business of credit institutions (MAK, 2002) and iii) Minimum requirements for the internal audit function of credit institutions (MaIR, 2000); will be merged in 2005 into the Minimum requirements for Risk Management (MaRisk). The new MaRisk will implement the second pillar of Basel II (Supervisory Review Process and Internal Capital Adequacy Assessment Process, Sound Practices for the Management and Supervision of Operational Risk).

10.2.5 Insurance

The basis for supervision of the insurance industry is the Insurance Supervision Act (VAG). BaFin circular 29/02 deals with the requirements regarding investment of insurance undertakings. This circular requires, amongst other things, a “compliance report” regarding investments of an insurance undertaking confirming compliance with the legal, regulatory and internal regulations and guidelines.

10.2.6 Investment Companies

According to German law, investment companies are specialized credit institutions. The Investment Act provides a catalogue of permissible assets that may be freely combined within the investment limits. The Derivatives Ordinance (2004) governs the specific risk management and risk measurement policies, required under the Investment Act when using derivatives in funds. Reporting obligations are designed on exceeding investment limits, statement of assets and material transactions to intensify and improve the market supervision of funds.

10.2.7 Anti Money Laundering

The Money Laundering Act (GwG) and the “Guidelines of the BaFin concerning measures to be taken by credit institutions to combat and prevent money laundering” are the main regulations designed to combat money laundering. The Money Laundering Act, which entered into force at the end of 1993 and was updated in 2002, specifies statutory duties for credit institutions and other businesses (financial services institutions, as well as some kinds of insurance business). The guidelines of the BaFin clarify the main statutory duties. These regulations represent minimum requirements. Credit institutions are called upon to make additional organizational and administrative arrangements.

11 THE FUTURE

Generally, intermediaries tend to be good at selling but would benefit from assistance in the areas of marketing, administration and business management.

Selecting and understanding unfamiliar international products to offer to their clientele and building up a "value added" relationship with specific product providers are two of the major issues Intermediaries are facing together with creating a residual value for a business built up over the years, very often from scratch.

Based on a small steady number of clients today, it is fairly clear that most intermediaries could increase their portfolio of clients reasonably easily through a better marketing approach and with the help of some supportive technical (administrative, legal and financial) assistance.

- For consumers who wish to use an Intermediary, the first thing to establish is that the Intermediary is, in fact, independent,

- The € may encourage consumers to look across borders for their financial-services products.

The consumers need advice that they do not find when buying over the Internet and a broader product mix than they would find in their local bank branch. Without the intermediary, the consumer is “thrown into the hands of large providers”.

ANNEX:

1. **MiFID** (Markets in Financial Instruments Directive)
   >> download

2. **IMD** (Directive of the European Parliament and on Insurance Mediation)
   >> download

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